DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

BOLIVIA

SECTOR PROGRAM TO SUPPORT FISCAL SUSTAINABILITY

(BO-0213)

TECHNICAL COOPERATION FUNDING FOR THE SECTOR PROGRAM TO SUPPORT FISCAL SUSTAINABILITY (BO-0225 AND TC-01-09-00-3)

LOAN PROPOSAL

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BASIC SOCIOECONOMIC DATA

For basic socioeconomic data, including public debt information, please refer to the following address:

http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata

ABBREVIATIONS

AFP	Administradoras de Fondos de Pensiones [Pension Fund Manager]
ARI	Acuerdo de Reforma Institucional [Institutional Reform (Restructuring) Agreement]
BONOSOL	Bono Solidario [Solidarity Bond]
BPRS	Bolivian Poverty Reduction Strategy
CC	Compensación de Cotizaciones [Contributions Compensation]
CESI	Committee on Environment and Social Impact
CPI	Consumer price index
DMB	Office of the Deputy Minister for Budget
FCC	Fondo de Capitalización Colectiva [Collective Capitalization Fund]
FCI	Fondo de Capitalización Individual [Individual Capitalization Fund]
FOBEPA	Fondo de Pensiones Básicas [Basic Pension Fund]
GDP	Gross domestic product
HIPC	Heavily Indebted Poor Countries
ICE	Impuesto al Consumo Específico [Specific Consumption Tax]
IEHD	Impuesto al Sector de Hidrocarburos [Hyrocarbon Sector Tax]
IMF	International Monetary Fund
INE	Instituto Nacional de Estadísticas [National Institute of Statistics]
IT	Impuesto a las Transacciones [Transactions tax]
IUE	Impuesto a la Utilidad de las Empresas [Corporate profit tax]
PAYG	Pay-as-you-go (pension system)
PRGF	Poverty Reduction and Growth Facility
PROFISI	Programa de Fortalecimiento Institucional del SIN [SIN institutional strengthening program]
RC-IVA	Régimen complementario al IVA [VAT complementary regime]
RUC	Registro único de contribuyentes [taxpayer master file]
SIN	Servicio de Impuestos Nacionales [Internal Revenue Service]
SIRAT	Sistema Integrado de Recaudación para la Administración Tributaria [Integrated Revenue System for the Tax Administration]
SNII	Servicio Nacional de Impuestos Internos [Internal Revenue Service]
SNRSR	Servicio Nacional de Rentas del Sistema de Reparto [National Pension Payments Office]
SPVS	Superintendencia de Pensiones, Valores y Seguros [Superintendency of Pensions, Securities and Insurance]
SWP	Semiannual work plan
UDAPE	Social and Economic Policy Analysis Unit
UFV	Unidades de Fomento a la Vivienda [Housing Development Units (indexed unit of account)]
UNDP	United Nations Development Programme
VAT	Value added tax

IDB **Inter-American Development Bank**
Regional Operations Support Office
Operational Information Unit

Bolivia

Tentative Lending Program

2003

Project Number	Project Name	IDB US$ Millions	Status
BO0178	Education Reform II	36.0	
BO0213	Fiscal Sustainability Program	63.0	
BO0225	TC Sustainability Support Program	2.0	
BO0179	Program to Support Productive Activities in Rural Areas	10.0	
BO0209	Justice Sector Support	5.0	
BO0216	Reactivation of the Center of La Paz	20.0	
BO0221	Land Titling and Legal Cadastre	20.0	
BO0219	Programa Sectorial de Apoyoa la Competitividad	35.0	
BO0220	Competitive System Support	10.0	
	Total - A : 9 Projects	**201.0**	
BO0200	Geotechnical and Environmental Protection of the Cotapata-Santa Barbara Highway	16.0	
	Total - B : 1 Projects	**16.0**	
	TOTAL 2003 : 10 Projects	**217.0**	

2004

Project Number	Project Name	IDB US$ Millions	Status
BO0208	Malaria Atention Program	6.0	
BO0210	Rural Infrastructure Program	10.0	
BO0224	Rural Electrification	10.0	
BO0207	Transparency National Program	10.0	
BO0215	Public Transportation Improvement in La Paz Metropolitan Area	20.0	
	Total - A : 5 Projects	**56.0**	
BO0202	Local Development Fiscal Adjustment Stage II	40.0	
BO0223	Drenage System Investment for Municipio La Paz	20.0	
BO0198	Support of Social Security Health Reform	10.0	
	Total - B : 3 Projects	**70.0**	
	TOTAL - 2004 : 8 Projects	**126.0**	

Total Private Sector 2003 - 2004	**0.0**
Total Regular Program 2003 - 2004	**343.0**

*** Private Sector Project**

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BOLIVIA

IDB LOANS

APPROVED AS OF MARCH 31, 2003

	US$Thousand	Percent
TOTAL APPROVED	**3,150,490**	
DISBURSED	2,570,371	81.6%
UNDISBURSED BALANCE	580,120	18.4%
CANCELLATIONS	240,916	7.6%
PRINCIPAL COLLECTED	1,066,381	33.8%
APPROVED BY FUND		
ORDINARY CAPITAL	1,158,261	36.8%
FUND FOR SPECIAL OPERATIONS	1,920,481	61.0%
OTHER FUNDS	71,748	2.3%
OUSTANDING DEBT BALANCE	**1,503,990**	
ORDINARY CAPITAL	445,210	29.6%
FUND FOR SPECIAL OPERATIONS	1,051,373	69.9%
OTHER FUNDS	7,407	0.5%
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	296,060	9.4%
INDUSTRY, TOURISM, SCIENCE TECHNOLOGY	224,157	7.1%
ENERGY	560,632	17.8%
TRANSPORTATION AND COMMUNICATIONS	755,918	24.0%
EDUCATION	98,180	3.1%
HEALTH AND SANITATION	382,363	12.1%
ENVIRONMENT	45,162	1.4%
URBAN DEVELOPMENT	73,856	2.3%
SOCIAL INVESTMENT AND MICROENTERPRISE	246,079	7.8%
REFORM _PUBLIC SECTOR MODERNIZATION	326,125	10.4%
EXPORT FINANCING	24,478	0.8%
PREINVESTMENT AND OTHER	117,479	3.7%

**** Net of cancellations with monetary adjustments and export financing loan collections.***

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BOLIVIA

IDB PRIVATE SECTOR "A" LOANS

APPROVED AS OF MARCH 31, 2003

	US$Thousand	Percent
TOTAL APPROVED	**118,147**	
AMOUNT APPROVED AND SIGNED	6,147	5.2%
DISBURSED	6,147	5.2%
UNDISBURSED SIGNED LOANS	0	0.0%
AMOUNT APPROVED AND NOT SIGNED	112,000	94.8%
CANCELLATIONS	8,853	7.5%
PRINCIPAL COLLECTED	768	0.7%
APPROVED BY FUND		
ORDINARY CAPITAL	118,147	100.0%
OTHER FUNDS	0	0.0%
OUSTANDING DEBT BALANCE	**5,379**	
ORDINARY CAPITAL	5,379	100.0%
OTHER FUNDS	0	0.0%
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	0	0.0%
INDUSTRY, TOURISM, SCIENCE TECHNOLOGY	0	0.0%
ENERGY	75,000	63.5%
TRANSPORTATION AND COMMUNICATIONS	37,000	31.3%
EDUCATION	0	0.0%
HEALTH AND SANITATION	6,147	5.2%
ENVIRONMENT	0	0.0%
URBAN DEVELOPMENT	0	0.0%
SOCIAL INVESTMENT AND MICROENTERPRISE	0	0.0%
REFORM _PUBLIC SECTOR MODERNIZATION	0	0.0%
EXPORT FINANCING	0	0.0%
PREINVESTMENT AND OTHER	0	0.0%

***** Net of cancellations with monetary adjustments and export financing loan collections.**

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BOLIVIA

STATUS OF LOANS IN EXECUTION AS OF MARCH 31, 2003

(Amounts in US$ thousands)

APPROVAL PERIOD	NUMBER OF PROJECTS	AMOUNT APPROVED *	AMOUNT DISBURSED	% DISBURSED
REGULAR PROGRAM				
Before 1997	7	301,600	233,264	77.34%
1997 - 1998	2	27,000	9,879	36.59%
1999 - 2000	8	189,300	46,027	24.31%
2001 - 2002	10	229,200	48,131	21.00%
2003	2	95,000	39,450	41.53%
PRIVATE SECTOR				
2001 - 2002	2	112,000	0	0.00%
TOTAL	31	$954,100	$376,751	39.49%

SECTOR PROGRAM TO SUPPORT FISCAL SUSTAINABILITY

(BO-0213)
(BO-0225)
(TC-01-09-00-3)

EXECUTIVE SUMMARY

Borrower and guarantor:	Government of Bolivia			
Executing agency:	Ministry of Finance			
Amount and source:	IDB sector loan (FSO): Technical cooperation loan (FSO): Local counterpart to TC loan: Nonreimbursable TC (FSO):		US$63 million equivalent US$2.0 million equivalent US$2.2 million equivalent US$500,000	
Terms and conditions for the sector loan, and for the reimbursable and nonreimbursable technical cooperation:		**Sector loan**	**Technical cooperation loan**	**Nonreimbursable technical cooperation**
	Amortization period:	40 years	40 years	NA
	Grace period:	10 years	10 years	NA
	Disbursement:	24 months (under no circumstances less than 18 months)	30 months	30 months
	Interest rate:	1% for first 10 years, 2% thereafter		NA
	Inspection and supervision:	1%		NA
	Credit fee:	0.5%		NA
	Currency:	Currencies comprising the FSO other than the Bolivian currency.		

Objectives: The general objective of the program is to strengthen fiscal sustainability in Bolivia. For this purpose, the program will use a three-tranche sector loan modality, addressing the following four policy areas: (i) tax administration; (ii) pensions policy; (iii) management programs to reduce pensions expenditure; and (iv) institutional reform of the public pension system. Actions and results achieved in these four components will all contribute towards the general objective.

Description: The program will be financed with a fast-disbursing sector loan, a reimbursable technical cooperation loan, and a nonreimbursable technical cooperation operation. The two latter parallel operations will support implementation of the policy measures being promoted, through four subprograms to be executed by the Internal Revenue Service and the Office of the Deputy Minister of Budget and Accounting through the Pension Payments Administration (see Annex II-1).

The sector loan will focus on the policy reforms promoted by the program, defining and establishing specific targets for implementation of the measures set out in the Policy Matrix (Annex I-2). It will be disbursed in three tranches of US$30 million, US$15 million and US$18 million, respectively. Both the technical cooperation loan and the nonreimbursable technical cooperation grant will be used to finance the consulting services and equipment required to achieve the program's objectives.

In the **tax administration area**, the first tranche is expected to see completion of the process of hiring new staff for the Internal Revenue Service (SIN) in the framework of the Institutional Restructuring Agreement (ARI); and presentation of evidence that budgetary resources have been earmarked for the SIN to enable the institution to function adequately. The second tranche envisages at least 70% progress in the agreed SIN efficiency performance indicators, together with evidence of budgetary transfers made to the SIN for 2003, and Bs 115 million included in the SIN budget for 2004. The third tranche expects at least 70% progress in the SIN indicators agreed for the second tranche; and evidence of transfers made to the SIN in the amounts agreed for 2004.

In the **pensions policy area**, the first tranche will include: (i) approval of a supreme decree prohibiting the addition of bonuses or alteration of pensions, and ratifying real and effective closure of the entire PAYG system as from 31 December 2001; (ii) presentation of the government proposal for the actuarial model, and two preliminary actuarial reports covering expenditure on pensions and compensation for contributions made, respectively; and (iii) presentation and approval of Law 2434 amending the rules for adjusting pension rates, which will henceforth be indexed to the Housing Development Unit (UFV) currency unit. The following is envisaged for the second tranche: (i) approval of a supreme decree systemizing the existing legal regulations; and (ii) government approval for a set of tools to control pensions expenditure and specifications for a plan of action. The third tranche includes policy measures which: (i) make corrections in line with the action plan and timetable approved in the second tranche; and (ii) present evidence of savings in pension expenditure arising from the differential between the exchange rate and the UFV (an estimated saving of US$20 million per year under current macroeconomic forecasts, particularly on inflation and the exchange rate).

In the policy area of **management programs to reduce pensions expenditure**, the first tranche will include presentation of: (i) a plan to combat fraud, expected to generate a total saving of Bs 150 million (about US$19.5 million); (ii) a supreme decree establishing conditions for recovering debts owed to the PAYG system; (iii) a program to combat arrears; and (iv) a detailed report on the balance sheet status of all complementary funds. Actions in the second tranche will include: (i) upgrading of the plan to combat fraud; (ii) implementation of the plan with an effective saving of Bs 65 million; (iii) approval of the supreme decree mentioned above; (iv) signing of agreements for recognition and payment of debt in arrears covering at least 10% of the total amount owed, and recovery of at least Bs 8 million in overdue debt recognized in the agreements; and (v) hiring of a consulting firm to produce a consolidated balance sheet. The third tranche will include: (i) implementation of the plan with an effective cumulative saving of Bs 150 million; (ii) signing of agreements for recognition and payment of debt in arrears covering at least a cumulative 20% at least of the total sum owed; (iii) recovery of a cumulative Bs 20 million of overdue debt recognized in the agreements; and (iv) presentation of the consolidated balance sheet and a plan to divest complementary fund assets.

As to **institutional reform** of the pension system, a supreme decree for system restructuring has been agreed for the first tranche. This makes the Office of the Deputy Minister for Budget (DMB) responsible for the system, and creates a Pension Payments Administration within the DMB, along with a deconcentrated National Pension Payments Office [Servicio Nacional de Rentas del Sistema de Reparto] (SNRSR). The relationship among the DMB, the SNRSR, and the Superintendency of Pensions, Securities and Insurance (SPVS) is thereby redefined. Actions in the second tranche include: (i) issuance of a ministerial resolution approving the organic structure and staffing of the SNRSR; (ii) signing of a technical support contract for supervision between the DMB and the SPVS; and (iii) signing of a management contract between the DMB and the SNRSR, making it possible to fulfill the program's objectives, and containing, as a minimum, targets in the following areas: a human resource plan in the framework of the Civil Service Statute; re-engineering of critical processes; rationalization of the payments circuit using bank accounts; digitization of basic management documents; and an execution timetable. The third tranche includes compliance with the restructuring targets of the SNRSR, as established in the management contract.

The Bank's country and sector strategy:

The Bank's strategy in Bolivia encompasses three lines of action; (i) economic growth and creation of opportunities; (ii) development of human capital and access to basic social services; and (iii) governance and consolidation of the reforms. The dialogue among the Bank, the authorities and other international cooperation partners, aimed at preparing a new country strategy, has stressed the creation of mechanisms for discussing the challenges facing Bolivian development, and the identification of instruments and sectors to provide more effective support to efforts aimed at avoiding further deterioration in economic conditions. In this regard, the Bank and donors agree on the importance of: (a) tackling the fiscal situation; (b) avoiding a further weakening of the banking sector; and (c) developing mechanisms to minimize the impact of the recession on the most poor. This operation is set within that process, placing special emphasis on fiscal sustainability, containment of expenditure in the public pension system, strengthening of pension management, and a deepening of reforms to improve tax administration.

Coordination with other agencies:

The Government of Bolivia has signed and implemented a stand-by arrangement with the International Monetary Fund (IMF), which was approved by the Board of Directors of that institution in April 2003. This agreement contains deficit-reduction targets requiring an increase in tax revenue and cuts in current pensions expenditure. The proposed program is consistent with these targets.

Both the IDB and the World Bank have been supporting institutionalization of the Internal Revenue Service. The Bank has provided support through the SIN Strengthening Program technical cooperation (loan 1043/SF-BO), which is currently in the final stages of execution. The World Bank has financed the Institutional Reform Program (PRI) which includes the SIN within its scope. In the pensions area, although the Superintendency of Pensions, Securities and Insurance has received support from the Bank and other agencies, the organizations associated with the pension system have not received international support.

Environmental and social review: Given its sector nature, the program will not finance civil works or the corresponding management actions. It therefore has no environmental impact, and precautions to protect the environment during execution will not be necessary. Profile II was considered and approved by the Committee on Environment and Social Impact (CESI) at its meeting of 28 March 2003.

Risks and benefits: The main risk facing the program relates to the political economy of the reforms—insufficient parliamentary support, and scant likelihood of identifying parallel beneficiaries that could compensate those who stand to lose from pension system reform. For this reason, a parametric reform of the system through a legislative package allowing for drastic expenditure adjustments is not seen as politically viable. The project prefers small-scale policy corrections, but focuses essentially on administrative rationalization and control of fraud. Since the project does not clearly specify who stands to lose from it and will be executed gradually, potential resistance by affected parties is diluted. Nonetheless, given the potential social extent of the fraud and the role played by intermediaries, organized resistance to the proposed measures cannot be ruled out. The application of new policies on communication and assistance to pensioners are seen as fundamental in mitigating these risks. The parallel technical cooperation will finance dissemination and communication activities.

In addition, strengthening of the tax and pension administrations faces risks stemming from the politicization of the public sector in Bolivia and the deficient professional level of its staff. This problem is less worrying in the case of tax administration, where modernization is taking place in the framework of an institutional mechanism supported by the World Bank and the IDB; the risk identified in this area concerns the sustainability of the mechanism once program funding has ended. To mitigate this risk, the program establishes conditions that seek to consolidate the institutional framework and disseminate its progress. The risk is greater in the case of the Pensions Administration, because of the weakness of this institution and the fact that its human resource policies have traditionally been associated with cronyism. In this case, the program aims to establish an organizational regime that would legitimize the institutional framework through professionalization, transparency and results-based management. The sufficiency of technical cooperation funds to sustain the mechanism is seen as a crucial variable for neutralizing this risk.

The proposed program will produce four main benefits. In the first place, it generates a deficit reduction of between 0.4% and 1% of GDP. Secondly, it underpins institutional reforms that have made professional management possible in the SIN. Thirdly, it generates a modern institutional organization for the pensions area of the PAYG system. Lastly, and as a subproduct of the above, it establishes technical conditions enabling the Government of Bolivia to undertake parametric reforms in the future, when political conditions warrant.

The expected outcome of the program's actions consists of a **permanent** reduction in the annual fiscal deficit of between 0.4% and 1% of GDP (between about US$32 million and US$80 million per year). The baseline for each of the variables, together with the corresponding information sources and means of verification, are presented in Annex I-2B.

In addition to this impact, the aim is to strengthen the institutional framework of tax administration, and restructure institutions in the pensions area within three years. Achieving these institutional outcomes in both administrations is seen as crucial for making the deficit reduction **permanent**. Lastly, the institutionalization process in the pensions area will lay technical foundations for simulating the medium-term effect of future parametric reforms, by using modern actuarial modeling instruments.

An ex post evaluation of the program and the parallel technical-cooperation operations will be conducted after 24 months of execution, to consider their immediate results and long-term impact. This will be financed with funds from the technical cooperation operation, which will be executed over a longer period than the sector program; the corresponding baseline has been agreed with the government.

Special contractual clauses on the sector loan:

Disbursement of funds in each tranche is conditional on: (i) maintenance of a macroeconomic climate consistent with the program's objectives; and (ii) compliance with the policy measures agreed for the respective tranche, as specified in chapter II and in Annex II-2 of the program.

The following are conditions precedent to the first tranche: (i) opening of a special account to manage program funds; and (ii) signing of agreements for technical cooperation operations parallel to this operation.

Special contractual clauses on the technical cooperation loan:

As a condition precedent to the first disbursement of the technical cooperation loan, the government will create an executing unit attached to the Pensions Administration.

Poverty-targeting and social sector classification:	This operation does not qualify as a social-equity enhancing (SEQ) project or as a poverty-targeted investment (PTI).
Exceptions to Bank policy in the sector loan:	None
Exceptions to Bank policy in the TC loan:	None
Procurement with the sector loan:	The fast-disbursing funds of the sector loan may be used to finance the aggregate foreign-currency cost of eligible imports from Bank-member countries. In this case, Bank procedures for sector loans will be applied as established in document GN-2001-2, for which international competitive bidding is not required. Funds will be disbursed as and when the borrower requests them, subject to evidence of compliance with all contractual conditions to the Bank's satisfaction.
Procurement with the technical cooperation loan:	Consulting services selection and contracting for all project procurements will be carried out in accordance with standard Bank procedures. In the case of goods procurement worth US$350,000 or more, and in contracts for consulting services in excess of US$200,000, the corresponding bidding processes and tenders must be conducted internationally.

I. REFERENCE FRAMEWORK

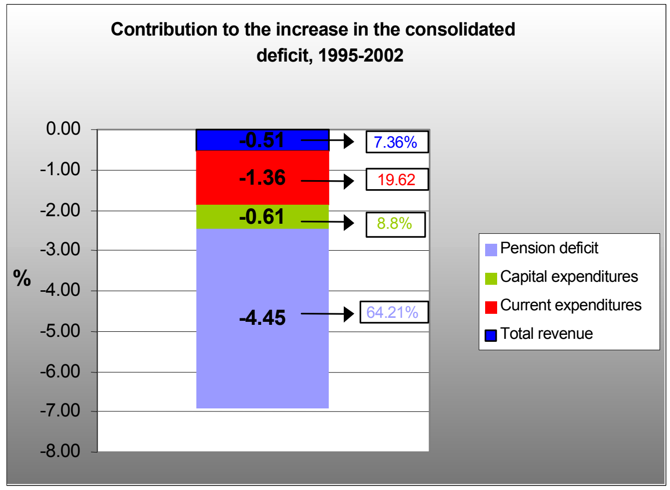
A. Macroeconomic context

1.1 Since 1999, the stability of the Bolivian economy has been compromised by external and domestic factors that have caused a slowdown in economic growth and heightened fiscal and financial fragility. In the external domain, economic performance has been undermined by falling prices among the main export products, compounded by dwindling capital flows and regional instability. During the last three years, the prices of zinc, soybeans and tin, which account for 36% of the country's exports, have fallen by more than 10%. The conclusion of contractual commitments associated with the capitalization program, together with expectations of currency depreciation generated by the devaluations in Brazil and Argentina, have caused capital flows to decline by about 8% of gross domestic product (GDP). In addition to the recessionary impact of these events on economic activity, there have also been domestic factors in play, such as the program to eradicate coca cultivation which began in 1997, which has represented direct and indirect revenue losses of around 3% of GDP (according to government estimates), and has spawned policies to control contraband, continuous conflicts that have undermined the investment climate, and a significant increase in the fiscal deficit resulting from pension reform.

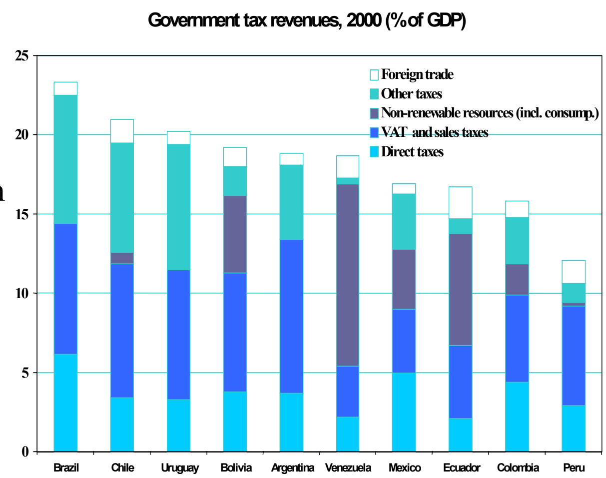
1.2 Following nearly a decade of 4% growth rates, economic expansion between 1999 and 2002 averaged just 1.3% per year. This has led to a fall in per capita income, which by late 2002 had dropped to just 90% of its 1998 level. When activities related to the production and export of gas are excluded, overall GDP growth is practically non-existent. In the financial domain, sluggish performance in the real sector of the economy has resulted in a deterioration in the quality of bank portfolios: the arrears rate climbed from 16.2% in December 2001 to 21.1% in August 2002. In addition, the crisis in Argentina, the political uncertainty surrounding the 2002 electoral process and the establishment of a new government, have put pressure on the banking sector where deposits shrank by 20% between January and August 2002—equivalent to 7% of GDP. This caused a reserve loss at the Central Bank amounting to about US$250 million during the first half of the year (a fall of 32%).

1.3 The situation is also not pretty on the public-finance side. During the last seven years, the consolidated public-sector deficit has expanded fourfold—from around 2% of GDP in the middle of the 1990s to over 8% today.

1.4 The expansion of the deficit has been marked by two key phenomena. On the expenditure side, reform of the pension system, which was approved in 1996 and implemented as from 1997, has turned out to be extremely costly. During 1995-2002, 64.2% of the growth in the deficit is explained by increases in pension spending (see figure). The remaining 35.8% of the increase in the fiscal deficit of the nonfinancial public sector is explained by particularly strong public expenditure growth during the last two years (both current and capital) and flat revenue.



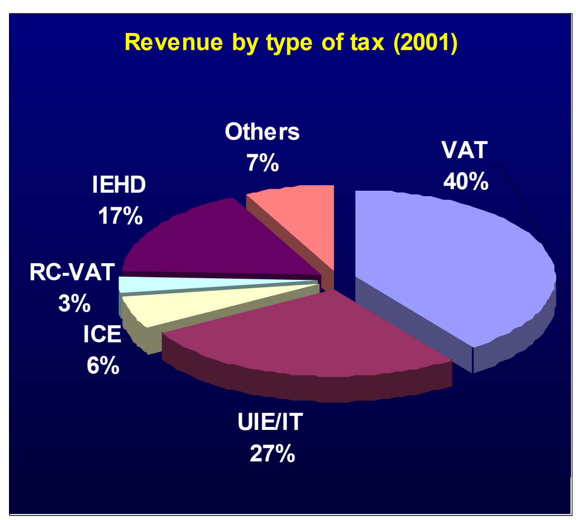
1.5 Against this backdrop, improving the tax system and its administration, and bringing expenditure growth under control, particularly in the pensions area, are both crucial to Bolivia's medium-term fiscal sustainability.



B. Characteristics of the Bolivian tax system

1. Tax structure

1.6 During the last two decades, and particularly following the initial tax reform introduced through Law 843 of 1986, Bolivia has made a major effort to simplify its tax administration and reduce costs.



1.7 The overall tax burden in Bolivia is above the average for Latin American countries, bearing in mind its relatively low per-capita income and the weak export diversification of its economy. Tax pressure, including that generated by subnational governments, increased by 2% of GDP between 1990 and 1996, since when it has held steady around 19% of

GDP. Bolivia has made major efforts to obtain tax revenues that are more stable and income-elastic.

1.8 The Bolivian tax system has a simple design, based mainly on 10 taxes, at national and subnational level. The main revenue sources are: value added tax (VAT), taxes on transactions (IT) and business profits (IUE), the VAT complementary regime (RC-IVA), specific consumption tax (ICE), taxes on the hydrocarbon sector (IEHD), and special simplified regimes. In keeping with other Latin American countries, Bolivia depends more on consumption taxes (about 70% of the total) than levies on income, capital or foreign trade. In addition, despite efforts to stabilize tax incomes, revenue levels rely heavily on the hydrocarbon sector, which contributes about 20% of the total. This reliance looks set to increase in the medium term, given the country's prospects for natural gas production. It should also be noted that, as a signatory member of the Andean Community, Bolivia's tariff policy options in the foreign trade domain are restricted by the provisions of that economic integration treaty.

2. Tax administration

1.9 The first significant steps in modernizing Bolivia's tax administration were taken in 1986 through Law 843, which substantially reduced the number of taxes (generally remaining in force today). In addition, a new functional structure was created for the Internal Revenue Service (SNII), the taxpayer master file (RUC) was established, together with a bank-based revenue collection system; and the first computer-based system to detect nonfilers and tax evaders was introduced along with the accompanying notification process. This initial reform produced significant results: tax revenue collected jumped from 4.5% of GDP in 1986 to 9.5% in 1997.

1.10 In 1997, however, revenue growth began to level off in both absolute and relative terms. The several possible explanations for this slowdown include: (i) technological weakness in the tax administration that prevented the deepening of verification and enforcement tasks; (ii) insufficient managerial capacity to introduce modern tax management criteria; (iii) inadequate budgetary funding; and (iv) problems with tax law that made it difficult for the administration to take effective action. All of this coexisted with growing political interference in the management of the tax service, reflected particularly in almost total staff renewal with every change of government, which prevented the necessary professionalization; and interference in inspection activities, which undermined the demonstration effect of inspection work and the equity of the system.

1.11 The Internal Revenue Service (SIN) was legally established in December 2000, as an autonomous body under public law, with administrative, functional, technical and financial independence. The SIN operates under the auspices of the Ministry of Finance, and is responsible for ensuring efficient and effective administration of the tax system. The new organization and current legal framework of the SIN are designed to solve the basic problems of tax administration in Bolivia, namely: continuous political interference, insufficient budgetary funding and the impossibility of managing staff properly because of their low wages, high turnover and selection on criteria other than merit and ability.

1.12 For this purpose, the new legislation made several fundamental changes: (i) the service is now an entity under public law with administrative, functional and technical independence; (ii) the executive president of the SIN is appointed by the President of the Republic for a fixed five-year term, from a shortlist approved by two thirds of the Chamber of Deputies; (iii) a Board of Directors is created, with five other members appointed by the same procedure as the executive president; and (iv) the service is given special financial treatment, receiving in principle up to 2% of revenue effectively collected from domestic taxes;[1] and (v) the system whereby technical and administrative personnel are contracted by the SIN is radically changed, with hirings now being conducted through public contest based on ability, as required by the Institutional Reform Agreement (ARI). The process is expected to be completed in mid-2003, with the induction of 505 new staff members.

1.13 The reform also established that, in keeping with its autonomy, the SIN would be required to make "annual commitments" with the Ministry of Finance covering at least the following: (i) annual revenue targets—global ones, and specific targets for district divisions and large-scale taxpayers—stating the assumptions on which calculations were based; (ii) institutional plans aimed at improving the quality of the service and increasing revenue collected; (iii) the percentage of revenue earmarked to finance the institution's budget; (iv) a summary, as relevant, of the institution's annual budget, included in the General National Budget; (v) the responsibilities of the Internal Revenue Service in executing such plans, and participation by the Ministry of Finance and other public bodies in the corresponding tasks; and (vi) grounds for exoneration of responsibility arising from nonfulfillment of targets and agreements established by the parties involved.

1.14 Throughout the process of SIN institutionalization, the Bank has carried out a variety of support activities, including the SIN Institutional Strengthening Program (PROFISI – IDB 1043-SF/BO), which is still in the execution stage. The PROFISI program contains three policy areas: organizational development, inspection, and information technology; it is in its final stages of execution.

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[1] The problem with the new funding regime, which in principle is positive for the tax administration, is that it places a ceiling on participation and requires annual negotiation of the percentage with the Ministry of Finance. This prevents the SIN from having a stable budgetary framework that would allow proper medium-term planning.

3. Lessons learned in tax administration

1.15 The overall evaluation of the current SIN legal framework is highly positive—comparable to that of many other Latin American countries—and offers major opportunities for the Bolivian tax administration to improve the way it operates and adequately fulfill its mission. The initial results of the SIN reform, covering work carried out in January-September 2002, reveal a 7.6% increase in revenue compared to the same period in 2001.

1.16 Nonetheless, the SIN institutionalization process, which began in late 2001, has been unfolding in difficult circumstances, given the specific situation of the organization, the economic and political climate in the country, and the difficulties inherent to any structural change. Although significant steps have been made in the process of change and institutionalization, progress is slower than desirable.

1.17 Accordingly, the SIN is going through an important phase that requires underpinning of the new model, clarification and stabilization of the budgetary framework, and finalization of tasks related to the change process—particularly hiring and adequately training new staff. At the same time, the SIN must also offer effective improvements in its operations and results, which means increased revenue. The proposed program includes targets for revenue collection efficiency as well as for budgetary allocation.

1.18 The Bank's experience of supporting tax administration reform, in Bolivia and elsewhere, clearly shows that modernization cannot be confined to information systems, training programs or institutional support programs. Such modernization processes need to be matched by institutional reform that recasts the relationship between policy-making bodies (mainly the Ministry of Finance) and revenue-collecting agencies. Institutional reform of this sort is impossible in the absence of an institutional framework for revenue collection that has appropriate incentives, adequate staffing and competitive wages, together with the technical and legal instruments needed to ensure its success. In this regard, the reform that has been supported by the Bank, which gives greater independence and professional stability to the tax service, is heading in the right direction. It sets a course, provides lessons and serves as an example for other key areas of public administration, such as management of the pension system in Bolivia.

C. The Bolivian pension system

1. The pension system prior to the 1996 reform

1.19 The Bolivian social security system was established in 1956. Until 1996 it consisted of two pillars, both of which were of the PAYG type. In the **first pillar**, known as the Basic Pension Fund (FOPEBA), employers had to contribute 4.5% of wages, employees 2.5%, and the government 1.5%. In 1969, the government set up

39 complementary pension funds to cover specific sectors of the economy. Although these "**second pillar**" funds had variable contribution rates, the average was about 6%. The retirement age was 50 years for women and 55 for men; and an individual would need to make at least 180 contributions to qualify. FOPEBA paid a monthly benefit equivalent to 30% of the minimum wage over the last five years, and the complementary funds topped this up with another 40%. Benefit rates were increased annually by 90% of the rise in the minimum wage. Although only FOPEBA benefits were actually guaranteed by the State, the latter's support for several of the funds represented an implicit guarantee.

1.20 Coverage was sparse: only 12% of the economically active population participated in the system. The organizations that managed the PAYG system suffered from serious governance problems. Both FOPEBA and the complementary funds lacked reliable accounting and actuarial information, and were subject to continuous union and political interference that resulted in high management costs and reserves being channeled into precarious investments. In 1995, only five of the funds had sufficient reserves to cover more than three years' benefits. Together, these features of the system generated a context in which fraud and evasion were rife.

1.21 The system was financially unsustainable; in 1995, the contingent liabilities of FOPEBA and the complementary funds were estimated at 40% of GDP. This financial insolvency was the result of many factors, of which five can be highlighted: (i) the debt owed to the system by the private and public sectors was high; (ii) the ratio of working/retired affiliates was 3:1, compared to a theoretical equilibrium ratio of about 10:1; (iii) inflation in the mid-1980s eroded the funds' assets and reserves; (iv) administrative costs absorbed 17% of total contributions, which implied major institutional weakness; and (v) the diversion of both FOPEBA and the complementary funds to satisfy political and union ends facilitated fraud and widespread evasion, particularly in the complementary funds. In this situation, the need for radical changes in the social security system became an urgent matter.

2. The 1996 reform

1.22 Pension system reform was undertaken in several stages, starting in 1994 with enactment of the *Capitalization Act*, which included the privatization of State firms and creation of a fund capitalized with shares in the privatized enterprises. The new investors received 50% of the equity in the capitalized firms by subscribing to a new issue of shares matching the existing ones. The remaining 50% of the shares were allocated to the workers of each firm and the adult Bolivian population, to be deposited in privately managed, deferred distribution share accounts.

1.23 In November 1996 the *Pensions Act* was passed, signaling the end of the PAYG system and providing for pension-fund assets to be administered by professional pension-fund managers (AFPs)[2] in the private sector. The Pensions Act established two funds: the Individual Capitalization Fund (FCI), and the Collective Capitalization Fund (FCC). The first of these is a contributory retirement fund consisting of individual accounts financed by the worker's contributions (10% of pay). Each worker's retirement pension comes from his or her own cumulative contributions, augmented by the returns obtained on their investment. The second fund consists of shares in the State firms that were transferred to Bolivian citizens under the 1995 Capitalization Plan. An annuity known as the Solidarity Bond (*Bonosol*) was also created, financed from the return on shares capitalized in the FCC. The legislation also provided for workers who had paid into the previous system without satisfying its requirements for retirement, to receive a benefit in recognition of contributions made, as from their effective retirement date under the new system. The AFP would pay this *Contributions Compensation* (CC) liability in return for monthly reimbursements from the Treasury. Participation in the new pension system would be compulsory for wage-earners but voluntary for the self-employed. The former are required to deposit 10% of their wages in their retirement account (FCI), and pay 0.5% as a commission to the AFP. Both amounts are withheld at source by the employer and transferred to the AFP.

1.24 The reform radically altered the governance scheme of the pension system, but left the institutional framework of the public PAYG system largely unaltered. Direct management of retirement savings was entrusted to private-sector AFPs, with safety mechanisms for the management of medium and long-term funds. Direct public management was restricted to the PAYG system that was in the process of disappearing. In addition, a regulatory scheme was established by creating a *Superintendency of Pensions, Securities and Insurance* (SPVS), including the Pensions Board (Intendencia de Pensiones). The SPVS was created as an independent body attached to the Ministry of Finance, with technical and administrative management autonomy. The Superintendency ensures benefits are paid and contributions received, and also oversees the security and solvency of investments, liquidity and profitability, together with other activities related to pension funds, AFPs and the other bodies envisaged in the law.

1.25 Reform of the pension system in Bolivia generated a perception of the demise of the pensions management body and the corresponding funds. This has had a dysfunctional effect on the institutional framework of the pension system, with far-reaching consequences in terms of rising costs. In the first place, the old legal organization and economic planning structures disappeared, leaving the system without effective analysis, control and organizational capacities. Secondly, the pension system was put in the hands of an extremely weak organization, the Pensions Administration, whose own dysfunctions have rendered it more vulnerable to fraud and management errors, thereby increasing systemic costs. At the same time, the Ministry of Foreign Trade was made responsible for liquidating

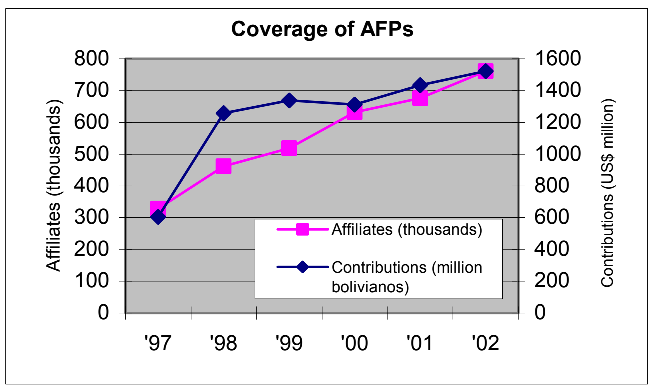
[2] At the present time there are two AFPs operating in Bolivia: Futuro de Bolivia, and Previsión BBVA, S.A.

the assets of the complementary funds. Thirdly, the absence of a political agency to oversee the management body was keenly felt. This task was vaguely entrusted to a Deputy Minister for Pensions within the Ministry of Financial Affairs, which has lacked the organization and resources needed to fulfill its governing and oversight role. Lastly, imprecision surrounding the conditions of final closure of the PAYG system has spawned endless disputes with interest groups that have absorbed the attention of the political body; and the latter's planning and analysis weaknesses have resulted in repeated concessions that have further inflated systemic costs.

3. Main outcomes of the reform

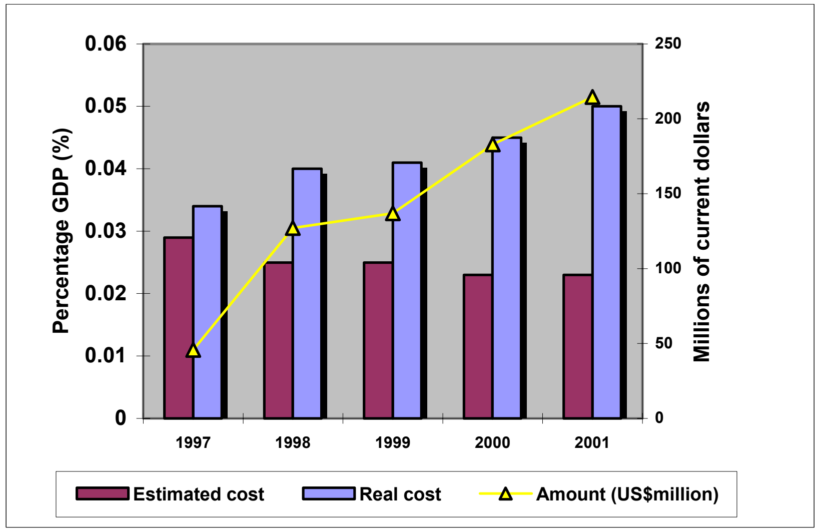
1.26 Six years after the reform, the new system displays clearly positive results in terms of coverage, mobilization of savings and greater transparency in the management of the population's funds. Nonetheless, there are also major challenges: the cost of the transition has been substantially higher than initially envisaged; the public system still has serious problems of financial viability and transparency; and its governance structure is extremely weak.

1.27 The new pension system started to operate in 1997, once the AFPs responsible for managing the individual and collective capitalization funds had been selected. Over the last five years the number of affiliates has grown on average by over 25% per year, and in 2002 the total stood at more than twice the highest number attained in the PAYG system. In late 2002, the system had about 760,000 affiliates, with accumulated assets from individual contributions in excess of US$1 billion. The number of contributing firms totaled about 18,000 in December 2002.



1.28 Greater coverage and asset accumulation have been accompanied by enhanced transparency, professionalism and balance in management. Prior to the 1996 reform, financial management of the pension system did not produce consolidated financial statements audited in accordance with generally accepted international standards, which facilitated dubious management of assets and reserves. Under the new system, not only are the AFPs supervised by the SPVS, but they are also required to file externally audited consolidated financial statements. Furthermore, whereas under the PAYG system there were no actuarial models to serve as the basis for medium-term management of assets and liabilities, under the new system the SPVS and the AFPs both have these tools available and make use of them.

1.29 The reform process has not been trouble-free. Six years on, the following four major issues still remain to be resolved: very high transition costs; fraud and evasion; systemic institutional weakness of the PAYG system; and pressures on the profitability of the capitalization system.



1.30 The **transition** has been very costly, with transfers from the Treasury running at about twice the levels originally projected. In 2001 and 2002 such payments represented some 5% of GDP. Existing projections suggest that this course is unsustainable unless measures are introduced to contain expenditure. The various explanations of this high cost include: a *larger number of pensioners* than expected; a *high average pension*—and higher than expected; and extremely costly *indexation rules*. In addition, the disperse regulations governing the PAYG system have made expenditure control difficult, thereby preventing its effective closure. This, in conjunction with deficient governance schemes, generates a framework that encourages fraud and evasion.

1.31 The *number of pensioners* initially calculated was underestimated by about 50,000 out of a total of 120,000. There are several factors explaining this. In the first place, the retirement age considered in the estimation was 65 years for men and 60 for women (the ages in force under the new system); but the law that was enacted maintained the retirement age for the old system at 50 and 55 years old for men and women, respectively. In addition, the law upheld the right to "early retirement" that existed in the PAYG system, even though this entitlement was not included in the original estimates. Lastly, the models used overestimated mortality rates in the pensioner group. The *average pension* effectively paid out was also larger than originally anticipated for several reasons. In the first place, the number of pensioners with relatively high incomes was underestimated (legal system and oil workers, for example). Secondly, the government signed two agreements after the reform in response to growing social pressure, which increased the cost of the transition: the so-called *Caracollo* and *Patacamaya* agreements. The first of these formalized an increase in the minimum pension from Bs 355 to Bs 550; and the second agreement then raised it Bs 850.

1.32 In the old PAYG system, pension rates received increases amounting to 90% of the rise in the minimum wage. The 1996 Pensions Act *indexed* pensions to the exchange rate of the boliviano against the US dollar. This regulatory change has generated additional outgoings of between US$15 million and US$30 million per year—compared to what would have occurred if pensions had been indexed to domestic inflation.

1.33 A major factor contributing to the transition cost relates to **illicit** or fraudulent **pensions**. Although it is hard to estimate the impact of such *fraud*, data from the Pensions Administration show, for example, that only 50% of a sample of some 14,500 new pensioners satisfied the legal age requirements. Some estimates put the fraud as high as 0.5% of GDP.

1.34 Fraud is easier to commit in a framework of major **institutional weakness**, with very few internal and external controls and minimal use of technologies and modern procedures for transparent benefit administration. This institutional weakness mainly reflects the fact that the design of the reform paid insufficient attention to the institutions that would govern the PAYG system, since it was assumed this was about to disappear. But its overall configuration and rules of administration did not undergo structural changes, and its management has not been supported by a stable legal framework.

1.35 At the present time, the pension system has highly *disperse regulations* (approximately 50 laws currently in force) which facilitates management indiscipline. In addition, the current institutional design does not appropriately separate the functions of management, supervision and policy definition; nor does it integrate management of the system's assets and liabilities. Administration and disposal of assets belonging to the defunct complementary funds was assigned to the Reorganization Unit of the Ministry of Foreign Trade and Investment—the unit assigned to administer the privatization process in general.

1.36 The perception that PAYG is a system in liquidation has led to a mistaken view of its current and future importance; in fact it plays an exceptionally important role in Bolivia's public accounts, and effectively controlling it is strategic for the economy. All of this highlights the urgent need to redefine its institutional framework, in order to enhance capacities for economic-financial planning and legal organization, as well as strengthening political-administrative control structures, and improving the effective capacities of the system's management body. From a strict fiscal discipline perspective, the specific characteristics of the PAYG system, given political and technical needs, recommend specific and separate treatment of the individual capitalization system separate from its problem seen.

4. Lessons learned from the 1996 reform

1.37 Since 1981 when the Chilean government reformed its pension system, over 10 Latin American countries have implemented this type of reform, wholly or partially turning their public PAYG systems into individual capitalization schemes. These reforms have served as a model for similar policies in Eastern Europe, and are used as a benchmark in debates on the issue in the United States and in Western Europe. While it may be premature to draw definitive conclusions on the effective results of these reforms, since they have been in place for less than 10 years in most countries, it is worthwhile considering a number of possible conclusions that could be drawn from the process thus far, and their relevance for the Bolivian reform.

1.38 Various authors[3] agree that the design of a structural reform of this type is based on a set of assumptions—considered to be *myths* by several authors—which are not necessarily always fulfilled either in theory or in practice. This analysis leads to three main conclusions.

1.39 In the first place, the existence of a *strong and effective institutional framework* is a key variable and a basic precondition for the success of a reform. The problems caused by institutional weakness in the State apparatus—high fiscal costs, corruption, etc.—are not necessarily resolved through privatization of the PAYG system. Secondly, the reforms' objectives can be achieved with a wide variety of instruments, where significant trade-offs and constraints come into play. The possible objectives of pension reform—better protection in old age, capital-market development, promotion of domestic investment, reduction of public expenditure—may be mutually conflicting, especially in developing countries. Thirdly, *not all options or sequences are always possible*, and the degree of market development, institutional capacity and fiscal strength may restrict the available policy options and sequences. In developing countries, capital markets are shallow, investors less well-informed and regulatory capacity weaker, which may reduce the chances of success in structural reform processes in the pension system.

1.40 The reform carried out in Bolivia is not immune to these general lessons. *Firstly*, although modern and appropriate supervisory and regulatory institutions were created, the institutional capacity of the PAYG system was not improved. Indeed, one could argue that it has actually diminished. The analysis carried out clearly reveals the absence of an institutional framework either for policy formulation, or for direct management of the PAYG system or its effective supervision. This institutional weakness underlies—although does not explain—the explosion of public expenditure on pensions. *Secondly*, it is clear that "privatization" of the

[3] See for example, Barr, N. (2000): "Reforming pensions: myths, truths and policy choices", *IMF Working Paper* No. 139; Orszag, P.T & Stiglitz, J.E. (2001) "Rethinking pension reform: ten myths about social security systems", in *New Ideas about Social Security*, The World Bank; Mesa-Lago, C. (2002): "Myth and reality of pension reform: the Latin American experience", *World Development*, Vol. 30, No. 8; Lindbeck, A. & Persson, M. (2003): "The Gains from Pension Reform", *Journal of Economic Literature*, Vol. 41, No.1.

system in Bolivia has not meant less State participation and a reduction in the fiscal cost of pension systems. *Thirdly*, the experience of other reforms highlights the importance of correctly sequencing policy decisions in a reform of this type. The initial conditions—in terms of institutional capacity, fiscal situation and capital market development—seriously restrict the range of options available.

1.41 Bolivia opted for deep reform, in the belief that "total" withdrawal by the State would result in a lower fiscal cost, and that the mobilization of savings would boost capital-market development. Nonetheless, the capital market can only develop when pension funds effectively invest in it; yet the financing needs of the transition process in Bolivia have resulted in over 75% of the AFP portfolio being invested in State bonds—which could lead to the system being described as a hidden pension system.

5. Short-term challenges

1.42 The reform transition process was highly vulnerable to political and stakeholder pressures. The transition from PAYG occurred in a systemic framework of legal and financial indiscipline, which spawned disperse regulations, low-quality information on expenditure, and non-fulfillment of obligations, thereby generating a steep rise in pensions expenditure. The difficulty of the transition process has produced tensions; and pressure to keep the PAYG system open is facilitated by the dispersion of its regulations (about 50 current regulations). In addition, information on the behavior of expenditure and future spending commitments are inconsistent and unreliable. This makes planning and control difficult, added to the fact that the revaluation of pensions is inconsistent with the system's financial capacities. The proposed program includes measures to reorganize and curtail expenditure in response to these challenges.

1.43 The fragility of social security management systems has opened the door to fraud and evasion. The available information clearly shows that control systems are weak. Both employer and State contributions are in arrears; and the estimated debt arising from nonpayment of contributions amounts to about one year's expenditure of the system (US$250 million). Debts owed to the system remain unrecovered. In addition, difficulties persist in liquidating and divesting the assets of the complementary funds, because of title defects and situations of unlawful occupation, limited information on their accounting status, and the complexity of divestment processes. The proposed program contains measures aimed at enhancing management efficiency, with a view to reducing the transition cost.

1.44 Lastly, the governance scheme of the PAYG system, and in particular its administration, does not have the capacities needed for organized, rigorous and efficient management of present and future commitments. The role that the scheme should play in combating fraud requires special capabilities, which the proposed program will help strengthen and reform.

6. The political economy of fiscal and pension reform

1.45 The results of the presidential and parliamentary elections held in June 2002 revealed an electorate with clear political divisions coalescing around four parliamentary forces (none of which had clear predominance), and the emergence of new political groups outside the traditional party system. This new configuration of forces made it hard to form the parliamentary majority needed to elect the new president, and subsequently conditioned the design and implementation of the government's program. Following protracted negotiations in August 2002, the new president was elected and a bipartite coalition government was formed with partial parliamentary support from other smaller parties.

1.46 In this situation of parliamentary weakness, the Government of Bolivia prepared a macroeconomic program in the final quarter of 2002 and first-quarter of 2003, aimed at restoring growth and controlling and reducing the fiscal deficit. At the same time, negotiations began with the IMF to reach a new agreement in the framework of the Poverty Reduction and Growth Facility (PRGF). The new government program agreed with the IMF included tax policy measures (introduction of income-tax, simplification of the tax schedule and changes in the hydrocarbons regime, among other items), together with expenditure policies covering control of payroll expenses and restraints on the growth of pension spending. All of these were incorporated into the sector plan through which the Bank was supporting the Bolivian government. This policy package was crystallized in the new 2003 budget Bill submitted to the legislature in February 2003. The measures included in this bill (particularly those relating to tax policy and measures affecting public-sector wages) were opposed by the parliamentary opposition, and they also provoked social mobilization and protests that resulted in serious disturbances and public disorder.

1.47 In view of this situation, the government withdrew the budget bill from consideration by the legislature and embarked upon a consultation process to design an alternative. Most of the government team was also replaced. A new budget bill has now been submitted to the legislature and is currently undergoing parliamentary scrutiny by the Finance Commission of the Chamber of Deputies. The new bill no longer includes the tax policy measures originally planned and contains less stringent expenditure control targets than initially envisaged, especially as regards current and capital expenditure. The budget presented by the government to congress is consistent with the new deficit targets agreed with the IMF, which are set out in a formal stand-by arrangement with that organization. This operation aims to increase tax revenue and reduce its inefficiencies, and bring pensions expenditure under control. In this regard, the measures and targets put forward are consistent with the agreement between Bolivia and the IMF.

D. Strategy and justification of the Bank's participation

1.48 The Bank's strategy in the country contains three lines of action: (i) economic growth and the creation of opportunities; (ii) development of human capital and access to basic social services; and (iii) governance and consolidation of the reforms. Following the election of a new president and inauguration of a new government in August 2002, the Bank initiated a review of this strategy. It also opened discussions with the new authorities and international partners on the challenges facing development and the priority areas within the government's agenda. Nonetheless, the economic and political situation prevailing in Bolivia has made it difficult to define actions to address the most pressing challenges facing the country, and to generate basic consensuses on medium and long-term strategy guidelines for State action in a set of areas likely to be crucial to progress in economic and social development over the next few years. In this context, the Bank's dialogue with the authorities and other international partners, aimed at preparing a new country strategy, has emphasized the creation of forums to discuss the challenges facing development in Bolivia, and identify instruments and sectors to make it possible to provide stronger support for efforts to avert further deterioration in economic conditions. In this regard, both the Bank and the donor community agree on the importance of: (a) tackling the fiscal situation; (b) avoiding a further weakening of the banking sector; and (c) developing mechanisms to mitigate the impact of the recession on the most poor.

1.49 This operation fits into this process, stressing aspects of fiscal sustainability, along with expenditure containment in the public PAYG system, a strengthening of pension management, and a deepening of reforms to improve tax administration. This is part of a more comprehensive program of immediate reforms aimed precisely at managing the fiscal crisis and avoiding further weakening of the financial sector. These are seen as the necessary starting points for generating a more favorable climate for economic recovery, together with more realistic macroeconomic scenarios allowing a reformulation of the Bolivian Poverty Reduction Strategy (BPRS).

1.50 The Bank's action in this area through a sector loan is justified as follows:

a. In the short run, to complement and strengthen interventions led by other donors to address the fiscal and financial crisis—in particular, the International Monetary Fund (through the Standby Arrangement) and the World Bank (through a programmatic loan to the financial sector).

b. In the medium term, to help prevent the current situation from eroding the benefits of the Heavily Indebted Poor Countries (HIPC) initiative, in both its original and expanded versions, where the Bank was the main provider of debt relief funds.

c. To help make a more gradual fiscal adjustment path viable in a complex political context.

d. Achieving macroeconomic stability is a key task within a competitiveness strategy, and in this regard it is an essential requirement for the first strategic component of the BPRS.[4]

1.51 The Bank's support through a sector loan thus seeks to: (i) deepen and consolidate previous interventions in the tax administration area, leading to greater mobilization of domestic resources; (ii) help Bolivia return to a sustainable fiscal path; and (iii) provide freely disposable funds to give the authorities room for maneuver following the sharp drain of reserves caused by the withdrawal of deposits from the banking system during 2002.

E. Coordination with other agencies

1.52 The Government of Bolivia has signed a Standby Arrangement with the IMF, which was approved by the Board of Directors of that organization in April 2003. The agreement contains deficit reduction targets involving increased tax revenue and a cut in current pensions expenditure. The proposed program is consistent with these targets.

1.53 Both the IDB and the World Bank have been supporting institutionalization of the tax service. The IDB has provided support through the SIN Strengthening Program (Technical Cooperation Loan 1043/SF-BO), which is currently in the final stages of execution. The World Bank has financed the Institutional Reform Program (PRI) which also encompasses the SIN. In the pensions area, although the Superintendency of Pensions, Securities and Insurance has received support from the Bank and other agencies, organizations associated with the PAYG system have not received international support.

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4 The Bolivian Poverty Reduction Strategy (BPRS) establishes four strategic policy areas around which the State's action will be coordinated: (i) expansion of employment and income opportunities; (ii) development of the productive capabilities of the poor; (iii) increased security and protection for the poor; and (iv) promotion of integration and participation. It also includes lines of action in cross-cutting areas such as institutionality, gender and environment.

II. THE PROGRAM

A. General objective

2.1 The program's general objective is to enhance fiscal sustainability in Bolivia.

B. Macroeconomic framework

2.2 The government that took office in August 2002 has made it a priority to regain macroeconomic stability. This commitment has been expressed through an economic program framed by a US$118 million Standby Arrangement with the IMF, approved by the Board of Executive Directors of that institution in April 2003. The program described in this document supports the adoption of measures included in the arrangement, and thus contributes to implementation of a macroeconomic policy framework more conducive to economic recovery.

2.3 The agreement with the IMF requires measures to be adopted in three areas: fiscal policy, monetary policy, and restructuring of the banking and corporate sectors. The fiscal program includes actions on both the income and expenditure side, which have been incorporated into the 2003 budget and will generate a fiscal deficit of 6.5% of GDP for that year—2.2% lower than in 2002. The bulk of the adjustment will come from changes made to the tax framework in the hydrocarbon sector (0.9% of GDP) and measures to curb pension spending (0.5%). The remainder of the adjustment will come from the approval of a new tax code (0.4%), increases in specific taxes (0.2%), elimination of tax allowances (0.1%), reduction in public investment (0.2%), government restructuring (0.1%), and improvements in tax administration.[5]

2.4 In the monetary policy area, domestic credit expansion will be kept on a tight rein, especially for funding the public-sector deficit. Lastly, to address the problem of financial and corporate fragility, the authorities have undertaken to strengthen the institutional structure of financial-sector supervision, and develop mechanisms making it possible to reduce the costs of corporate restructuring (Bankruptcy Act, Law on the Management of Corporate Sector Debts).

2.5 As implementation of these measures requires technical assistance in various areas, IMF, the World Bank and IDB are coordinating their activities to support the government in tasks that need to be performed simultaneously.

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[5] These measures total 2.4% of GDP, thereby leaving space in the 2003 National Budget for a wage increase equivalent to 0.2% of GDP.

C. Structure of the program

2.6 The program will be financed with a fast-disbursing sector loan, a reimbursable technical cooperation loan, and a nonreimbursable technical cooperation grant. The two latter parallel operations will support implementation of the policy actions being promoted, through four subprograms to be executed by the Internal Revenue Service and the Office of the Deputy Minister for Budget through the Pension Payments Administration (see Annexes II-1A and II-1B).

2.7 The sector loan focuses on the policy reforms promoted by the program, defining and establishing specific targets for implementing the measures included in the policy actions matrix (Annex I-2). The sector loan will be disbursed in three tranches of US$30 million, US$15 million, and US$18 million, respectively. The technical cooperation loan and the nonreimbursable technical cooperation grant will be used to finance consulting services and procure the equipment needed to achieve the program's objectives.

D. The program's policy areas

2.8 The program will use a three-tranche sector loan modality encompassing the following four policy areas, whose outcomes will contribute to the general objective: (i) tax administration; (ii) pensions policy; (iii) management programs to reduce pensions expenditure; and (iv) institutional reform of the public PAYG system.

1. Tax administration

2.9 The specific objective in this policy area is to achieve a 3% real annual increase in tax revenue, through greater compliance by citizens with tax obligations as a result of a better functioning tax administration. To achieve this, the SIN needs to take steps in the following priority areas:

a. Strengthening of the fight against fiscal fraud by improving data held in the taxpayer master file; reduction of unfulfilled obligations; more and better quality inspection activities; and strengthening of the enforced collection area.

b. Strengthening of inspection activities, particularly in the hydrocarbons sector, where few human and material resources have traditionally been deployed despite its major revenue potential.

c. Upgrading of information services, through expansion and modernization; improving services of information and assistance to the citizen, and reducing the burden of compliance with fiscal obligations.

d. Expansion and improvement of the SIN information system, evolving from a distributed system to a centralized model, incorporating the enforced collection area.

e. Provision of training for SIN personnel, whose knowledge of fiscal laws and tax procedures tend to be weak, especially since many of the staff are recent hirings.

f. Fight against corruption by implementing a set of programs designed for this purpose.

2.10 In the tax administration area, the first tranche will see completion of the process of hiring new SIN personnel (505 new staff) in the framework of the Institutional Restructuring Agreement (ARI); and presentation of evidence of SIN resources assigned in the budget, including: (i) a minimum of Bs 102 million in 2003, to guarantee the current functioning of the institution, together with technological modernization and compliance with the agreed indicators; and (ii) indication of the source of funds committed and specific activities to be financed therewith. The indicators agreed cover the fight against fraud, taxpayer assistance and training during the second and third tranche of financing.

2.11 The second tranche anticipates at least 70% progress in the agreed SIN efficiency improvement indicators, calculated using the formula presented in Annex I-2B; together with evidence of transfers made to the SIN in the amounts agreed for 2003, and incorporation into the SIN budget of Bs 115 million for 2004. The third tranche envisages at least 70% progress in the SIN efficiency improvement indicators agreed in the second tranche; and evidence of transfers made to the SIN in the amounts agreed for 2004.

2.12 The SIN will be required to achieve a 3% real increase in net tax revenue per year, once the impact of possible regulatory changes and the evolution of the economic situation have been taken into account.[6] This revenue effort responds to the need to guarantee the SIN the financial, human and material resources that are essential for its performance. For this purpose, the Ministry of Finance will need to ensure SIN funding amounting to at least Bs 102 million in 2003 (approximately US$13.6 million at the current exchange rate), and Bs 115 million (about US$15.3 million) for 2004.

2.13 In addition to achieving revenue growth, the expansion of information and taxpayer assistance services should simplify the formal obligations on taxpayers and ease the indirect fiscal pressure involved in complying with the tax system. Ambitious targets will be established for reducing non-compliance with fiscal obligations: in the case of large-scale taxpayers the non-compliance rate will be cut to 7% from its

[6] The new 2003 budget Bill submitted by the Bolivian government set a revenue growth target of 5% for the fiscal year. Nonetheless, the sector program maintains a stable increase of 3% (for 2003 and 2004), considering this to be sufficiently demanding.

current level of 18.3%; and for the rest of the taxpayer universe the level of non-compliance will be brought below 27% (compared to 36.3% at the present time).

2.14 Inspection actions will be made more effective and the inspection unit more efficient:[7] (i) the targets established anticipate over 10,000 inspection actions by the end of the program, with a 45% improvement in yield per inspector; (ii) an estimated 60% growth in revenue collected per inspector by the end of the period; and (iii) control over the hydrocarbon sector will be tightened, with the number of firms subject to inspection in this sector to be almost doubled by late 2004. In the area of enforced collection, the target established involves virtually doubling the amount collected, rising from Bs 45 million in 2002 to Bs 84 million in 2004.

2.15 It is also intended to improve taxpayer information and assistance services, by making certain facilities available on the Internet: (i) the most frequent questions on tax issues; (ii) tax declaration forms; (iii) a help program; and (iv) on-line reception of tax declarations from taxpayers (compulsory for large-scale taxpayers and optional for the remainder). In addition, a service will be established to receive complaints and suggestions, with a unit responsible for this being set up.

2.16 Achieving all these targets requires strengthening in the following areas: (i) data-processing capacity, where it is proposed to consolidate information from all taxpayers in a single nationwide database; (ii) the capacity of the SIRAT integrated revenue system, where a new module will be introduced allowing for enforced collection; (iii) management information through a system to provide the SIN management and Office of the Deputy Minister for Tax Policy with indicators needed to oversee management and policy formulation; and (iv) staff training, for which a plan is being established that will be fully developed during 2003 and 2004. These strengthening activities will be financed by the technical cooperation that accompanies the sector loan.

2.17 Ultimately, the indicators included in the matrix assume an increase in the effectiveness of the organization and, notwithstanding the larger budgetary funding to be assigned to it, a higher level of efficiency over the next few years. Nonetheless, the impact of the measures on the organization, and their effect on revenue collection, will take time to bear fruit; and results will probably not be clearly visible until the second or third disbursements, scheduled for December 2003 and 2004, respectively.

2. Pensions policy

2.18 The specific aims of this policy area are as follows: to comply with the provisions of the reform, complete the periods set for transition and closure of the PAYG

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[7] The base year is 2002. A 215-strong team of inspectors is envisaged.

system and calculate expenditure precisely. For this purpose: (i) the current regulation will be rationalized and simplified, which, in compliance with rules established in Law 1732: prohibits the addition of bonuses or alteration of pensions, apart from the increases established by law; ratifies the effective and real closure of the PAYG system; and systemizes the existing body of laws; (ii) future expenditure commitments in respect of pensions and entitlements to contributions compensation will be quantified, by setting up and estimating an actuarial model. This will also provide technical criteria for analyzing the feasibility of undertaking parametric reforms in the future and applying corrective measures to PAYG benefits; and (iii) the current revaluation system will be replaced by another based on Housing Development Units (UFV).

2.19 The UFV is a reference index that reflects the trend of prices on a daily basis, calculated from the Consumer Price Index (CPI) as published by the National Institute of Statistics (INE). In a macroeconomic scenario that foresees real positive devaluation, re-indexing on a domestic index will generate substantial fiscal savings. Re-indexing on a domestic index is also consistent with the fact that the expenditure basket relevant to pensioners is denominated in local rather than foreign currency. In addition, the UFV is the unit the government uses to reindex a multitude of contracts and it is widely known by the population.

2.20 The first tranche will witness the following: (i) approval of a supreme decree, which, in compliance with regulations established in Law 173 prohibits the addition of bonuses or alteration of pensions, as from the date of the decree, except for the increases established by law; and ratifies effective and real closure of the entire PAYG system as from 31 December 2001; (ii) presentation of the government proposal for the actuarial model and two preliminary actuarial reports—on pensions expenditure and on contributions compensation, respectively; and (iii) presentation and approval of Law 2434, amending article 57 of Law 1732, by which pension increases are tied to the UFV, and approval of the corresponding regulatory supreme decree.

2.21 The second tranche will involve: (i) approval of a supreme decree systemizing the existing body of laws; and (ii) government approval for the following expenditure control instruments: the actuarial model; definitive actuarial reports on pensions and compensation for contributions paid; identification of the corrective measures to be adopted, and quantification thereof based on the actuarial reports; and approval of an action plan and corresponding implementation timetable.

2.22 The third tranche includes policy measures which: (i) implement corrective measures in accordance with the action plan and timetable approved in the second tranche; and (ii) provide evidence of savings in pensions expenditure arising from the differential between the exchange rate and the UFV (savings estimated at US$20 million per year, according to current macroeconomic predictions, particularly with regard to inflation and the exchange rate).

3. Management programs to reduce pensions expenditure

2.23 The specific objective in this policy area is to enhance management efficacy in order to curb expenditure. To this end: (i) support will be provided to implement a program to combat pension fraud; (ii) firms will be given incentives to pay their overdue contributions, through a supreme decree setting out general conditions for payment agreements and plans to be signed with firms that have contributions in arrears; sanctions will also be defined for failure to fulfill the payment plans; or, in their absence, non-compliant firms will be excluded from State contracts and the banking system risk center will be notified; (iii) implementation of a program to recover overdue debt through a program to combat arrears; and (iv) more transparent information on complementary fund assets.

2.24 The first tranche will see presentation of the following: (i) a plan to combat fraud, generating an expected total saving of Bs 150 million (approximately US$19.5 million) by the date of the third disbursement; (ii) a supreme decree setting out conditions for recovering debts owed to the PAYG pension system; (iii) a program to combat arrears, including a detailed financial statement of the overdue debt; a plan for the signing of agreements to recognize and pay overdue debt consistent with the targets for debt recovery contained in the second and third tranches; and (iv) a detailed report, certified by the Ministry of Finance, giving details on the balance sheet status of all complementary funds.

2.25 The second tranche will include the following: (i) updating of the plan to combat fraud, to take account of progress on institutional restructuring in the PAYG system; (ii) implementation of the plan, generating an effective saving of Bs 65 million; (iii) approval of the supreme decree mentioned in the previous paragraph; (iv) signing of agreements for recognition and payment of overdue contributions covering at least 10% of the total amount owed, and recovery of at least Bs 8 million in debt recognized in the agreements; (v) hiring of a consulting firm to prepare the consolidated balance sheet.

2.26 The third tranche envisages: (i) implementation of the plan, generating an effective cumulative saving of Bs 150 million; (ii) signing of agreements for recognition and payment of overdue contributions covering at 20% of the total amount owed; (iii) recovery of Bs 20 million of overdue debt recognized in the agreements; (iv) presentation of the consolidated balance sheet and a plan to divest complementary fund assets.

4. Institutional reform of the PAYG system

2.27 Given the institutional weakness in the PAYG system, the objective of this policy area is to establish an institutional and legal framework making it possible to control expenditure and establish appropriate management incentives, in order to strengthen the transparency and legal security of the system. With these aims, a scheme will be implemented that separates and clearly defines the functions of policy formulation, regulation and supervision, and execution thereof. For policy formulation, the current General Pensions, Securities and Insurance Administration (attached to the Office of the Deputy Minister for Financial Affairs) will be turned into an office working exclusively on policy formulation for the PAYG system, with an institutional mandate to promote expenditure control and efficiency in the administration of public pensions. In the regulatory area, the aim will be to strengthen regulatory and supervisory capabilities, concentrating these currently disperse functions in the Superintendency of Pensions, Securities and Insurance (SPVS). At the operational level, for execution of actions, the current Pensions Administration will be restructured into the SNRSR; this will have exclusively executive functions and no regulatory faculties. The functional relationship between the Ministry of Finance and the SNRSR will be formalized in a management contract. In short, the three levels needed for proper management of the PAYG system (policy formulation, regulation and execution of actions) will be hierarchically defined with appropriate incentives.

2.28 In the first tranche, it has been agreed to approve a supreme decree covering at least the following aspects: (i) assignment of responsibility for the PAYG system to the Office of the Deputy Minister for Budget (DMB), including functions of planning, organization and control of the management body; (ii) creation of a Pension Payments Administration within the DMB; (iii) creation of a deconcentrated SNRSR, attached to the DMB, to take exclusive charge of operational management of the PAYG system in replacement of the Pensions Administration; (iv) formalization of the relationship between the DMB and the SNRSR through a management contract, including targets for results-based management and institutional strengthening; and (v) technical support from the Superintendency of Pensions, Securities and Insurance to the DMB to enable it to discharge its supervisory functions through a technical assistance contract.

2.29 The following is envisaged for the second tranche: (i) issuance of a ministerial resolution approving the organic structure and staffing of the SNRSR; (ii) signing of a technical support contract for supervision between the DMB and the Superintendency of Pensions, Securities and Insurance; and (iii) signing of a management contract between the DMB and the SNRSR, making it possible to comply with program objectives. This will contain targets in the following areas at least: a human resource endowment plan in the framework of the Civil Service Statute; reengineering of critical processes; rationalization of the payment circuit using bank accounts; digitization of basic management documents; and an execution timetable. The third tranche includes fulfillment of the restructuring targets of the SNRSR, as established in the management contract.

E. State of compliance

2.30 The government has a strengthening proposal defined for each of the policy areas, which has been discussed with the Bank. The government and the Bank team have also set quantitative targets that have been incorporated into the attached policy conditions matrix. These are consistent with the global targets agreed with the IMF.

2.31 In the tax administration area, the SIN technical team, with support from specialized consultants, has defined a set of specific indicators (consisting of the indicators themselves, together with their baselines and proposed targets), compliance with which would be monitored to satisfy the requirements of each disbursement. In the pensions area, agreement has also been reached with the government on the content and sequence of each of the indicators included as program targets.

2.32 It is estimated that resources will be required for the technical cooperation actions needed to fulfill the program targets. Through its two components, the technical cooperation project will contribute to the following: (a) an increase in revenue-collection capacity for the tax administration (SIN), by improving data-processing tools (unified taxpayer databases and equipment for processing centralized data), together with more solid training in inspection techniques, and institutional consolidation of the SIN; and (b) containment and reduction of expenditure on public pensions, by strengthening the institution responsible for its management (i.e. the Pensions Administration). Annex II-1 contains details of these actions.

F. Cost and timing

2.33 The program will be financed with two loans using resources drawn from the Bank's Fund for Special Operations (FSO), and a nonreimbursable technical cooperation grant also financed out of FSO resources, details of which are as follows:

a. A fast-disbursing sector loan for the equivalent of US$63 million, with disbursements to be made in three tranches of US$30 million, US$15 million and $18 million, respectively; execution and disbursement are expected to take 24 months (under no circumstances less than 18 months). As this is a sector loan, the proceeds are not linked to execution of any specific component individually, but to comprehensive fulfillment, to the Bank's satisfaction, of the policy measures defined and agreed in this loan document;

b. A reimbursable technical cooperation loan to be executed by the Ministry of Finance for an amount equivalent to US$2 million, with a minimum execution period of 24 months, to be disbursed over 30 months (the latter in no circumstances to be less than 24 months), supported by local counterpart funding equivalent to US$2.2 million; and

c. A nonreimbursable technical cooperation grant, to be executed by the Ministry of Finance amounting to the equivalent of US$500,000, to be executed over 24 months and disbursed over 30 months.

2.34 With regard to the disbursement timetable for the sector loan, the first tranche is expected to be released when the agreed policy measures have been fulfilled and approved to the Bank's satisfaction. This is scheduled for the month following the signing of the loan contract. The second tranche is expected to be released at the end of 2003, followed by the third tranche about 12 months later, although deadlines may vary. This gives a total expected disbursement period of 24 months (not less than 18 months), counted from the date of contract signing.

2.35 The structure and sequencing of disbursements of the sector loan are justified as follows:

a. In the tax administration area, SIN institutional reform has already been carried out, and all that remains is to complete the hiring of new staff in the ARI framework. In addition, the continuity of institutional reforms undertaken during the last two years, which the program seeks to underpin, will be ensured by allocating an adequate budget to the SIN. Both issues are included in the first financing tranche;

b. In the pensions area, effective closure of the PAYG system, which is a crucial measure for ensuring system sustainability, will be completed before the first disbursement;

c. The legal regulations allowing the reindexation of pensions enters into effect before the first disbursement. This is crucial for system sustainability; and

d. PAYG restructuring will be formalized before the first disbursement, making it possible to have a suitable institutional framework in place for containing expenditure and reducing fraud and arrears.

III. Program Execution

A. Borrower and executing agency

3.1 The borrower in this program will be the Republic of Bolivia, with the Ministry of Finance acting as executing agency—in close collaboration with the Internal Revenue Service (SIN) for the tax administration policy area. Actions concerning tax administration policy will be executed directly by the SIN under a management contract signed with the Ministry of Finance. Actions impinging on other areas will be executed by the Office of the Deputy Minister for Budget (DMB), attached to the Ministry of Finance, which is expected to sign an agreement with the National Pay-as-you-go System Pension Service (SNRSR).

B. Execution and management

3.2 The execution and management framework proposed for the tax administration area is based on the current scheme in which the Internal Revenue Service has an Institutional Restructuring Agreement (ARI) in place with the Ministry of Finance. The targets included in this program are consistent with ARI objectives and targets.

3.3 The execution and management framework proposed for the pensions policy area has two key pieces: firstly, delegation of planning, organization and oversight functions to the apex organization for expenditure control (DMB); and secondly, the establishment of a modern and strengthened, exclusively managerial unit (SNRSR) directly supervised by the DMB. This will have a contractual relationship allowing it to establish political objectives for institutional strengthening, expenditure control and the fight against fraud, together with effective monitoring and control.

3.4 In addition, the need for a long-term perspective that provides criteria for political negotiation with groups affected by closure of the PAYG system, and the political difficulties likely to be involved in creating a presidential pensions delegate, recommends establishing a permanent post to advise the Minister of Finance.

3.5 The DMB would become the top-level body with political responsibility, exercising the following functions:

a. Preparation of the system’s actuarial model and financial planning;

b. Regulation and organization of the PAYG system;

c. Political, economic and administrative control and monitoring of the SNRSR; and

d. Supervision and audit.

3.6 These functions will be exercised by the DMB through the creation of a Pension Payments Administration. For supervision and audit of the SNRSR, the Administration will avail itself of the technical capacities of the Superintendency of Pensions, Securities and Insurance, under a technical assistance contract.

3.7 As the management body, the SNRSR would be constructed as follows:

a. Attachment to the DMB, under the legal regime corresponding to a deconcentrated National Service (Supreme Decree 26973, article 46);

b. Limitation of its functions to those which are merely instrumental for effective management of the system's commitments; removal of any remit in terms of legal and economic oversight, submitting other acts to the oversight and supervision of the governing body;

c. Maintenance of the legal and patrimonial capacity of the management body;

d. Adoption of a new organic structure and staffing consistent with its functions, critical processes and objectives in terms of expenditure control and the fight against fraud;

e. Professionalization of the entity's staff teams, under the Civil Service Statute; and

f. Although the traditional model would require a collegiate body for tripartite participation by public administration, employers and workers in the control and supervision of the management entity, the fact that the entity's social basis is disappearing makes such a body unnecessary;

3.8 Lastly, the DMB and the SNRSR would be linked through a multi-year management contract, expressed in annual operating plans, containing the following basic components:

a. Definition of management policy targets for the SNRSR in terms of efficacy and efficiency, emphasizing control of expenditure and the fight against fraud, together with legal security and recognition of taxpayers' rights;

b. Definition of institutional strengthening targets including: (i) a human resource endowment plan in the framework of the Civil Service Statute; (ii) reengineering of critical processes; (iii) rationalization of the payment circuit through bank accounts; (iv) digitization of basic management documents; and (v) an execution timetable.

c. Allocation of resources needed for the Pensions Administration to fulfill the institutional restructuring targets; and

d. Establishment of systems for periodic reporting and monitoring between the DMB and the SNRSR.

C. Procurement

3.9 The fast-disbursing funds of the sector loan can be used to finance the aggregate foreign-exchange cost of eligible imports from Bank-member countries. In this case, Bank procedures on sector loans will be applied as per document GN-2001-2, which do not require international competitive bidding. Funds will be disbursed when the borrower requests them, subject to evidence of compliance with all contractual conditions to the Bank's satisfaction.

D. Accountancy and audit

3.10 On the issue of accounting and financial records and external audit, the loan contract establishes the following:

a. Acting through the executing agency, the borrower will: maintain separate accounting and financial records, together with support documentation relating to the use of the financing; prepare disbursement requests and present them to the Bank, and ensure such documents are kept available for inspection by the Bank and/or the external auditors;

b. The borrower, acting through the executing agency, will maintain specific and separate bank accounts to manage the financing, and will submit evidence to the Bank of having opened such accounts, as a condition precedent to the first disbursement; and

c. The Bank reserves the right to request financial reports from the borrower on the use of the financing. These will be certified by a firm of independent auditors previously accepted by the Bank. The auditors will be hired in accordance with Bank procedures, and will prepare reports in accordance with Bank rules on the subject and under the agreed terms of reference.

E. Inspection and supervision

3.11 The Bank will establish the inspection procedures it deems necessary for satisfactory execution of this sector loan. The borrower will cooperate fully by providing all necessary assistance and information.

3.12 In order to ensure adequate fulfillment of the program's actions, with the expected impact, the parallel technical cooperation will finance periodic operational evaluations associated with the sector loan disbursements, as described in the following paragraph.

F. Monitoring, oversight and ex post evaluation

3.13 In view of the complexity and scope of the program, the executing agency will present semiannual progress reports to the Bank, making it possible to ensure timely compliance with the accompanying policy measures, especially for the second and third tranches of the financing. To complement these semiannual reports, the executor will present to the Bank detailed plans for satisfying the conditions precedent to disbursement of the second and third tranches, at least 45 days in advance of the dates established for each disbursement.

3.14 In addition, the government and the Bank have agreed to conduct an ex post evaluation of the program as a whole six months after the sector loan has concluded. This evaluation would be financed with resources from the reimbursable technical cooperation loan which accompanies the sector loan. The Bank and the government have reached consensus on the indicators and baseline to be used for these evaluations. Detailed terms of reference for the consulting services will be agreed in advance with the Bank.

G. Environmental repercussions of the operation

3.15 The project does not have any environmental impact. Its profile II was considered and approved by CESI at its meeting on 28 March 2003.

H. Conditions precedent to disbursement

3.16 Disbursement of the proceeds of each tranche is conditional upon: (i) maintenance of a macroeconomic climate consistent with the program's objectives; and (ii) compliance with the policy measures agreed for the respective tranche, as specified in chapter II and in Annex II-2 of the program.

3.17 For the first tranche, conditions precedent entail: (i) opening a special account to manage program funds; and (ii) signing the technical cooperation agreements parallel to this operation.

3.18 The project team will evaluate the information presented by the country for implementing the agreed policy measures, and will prepare the corresponding reports for the Bank's Management and Board of Executive Directors, in order to request disbursement authorization in compliance with current policy.

I. Policy letter

3.19 The Bank agrees with the borrower regarding the macroeconomic and sector policies contained in the policy letter included as Annex I-1 of this document. The letter summarizes economic policies and actions aimed at: improving tax administration; reorganizing and rationalizing expenditure in the PAYG system, and that relating to compensation for contributions made; together with management programs to reduce expenditure, and institutional strengthening of the area.

IV. PROGRAM VIABILITY, BENEFITS, RISKS AND EVALUATION

A. Viability

4.1 In recent years the Government of Bolivia has implemented public administration reforms through the Institutional Reform Program (PRI). This program targets three institutions considered critical in the Bolivian government: the National Highways Administration, the Customs Service and the Internal Revenue Service. The main characteristic of the PRI consists of giving these institutions a high degree of independence from political pressure, and providing them with a framework of professionalized management, adequate human resources and a set of results-based incentives.

4.2 In the **tax administration** area, substantial progress has been achieved in the design and implementation of this modern administration scheme, which is based on a technically independent Internal Revenue Service, endowed with appropriate human resources and managed through results-based contracts. The scheme has been called into question, however, since it has proven more costly than originally anticipated. In view of this, it is important to ensure that SIN management strives for increasing institutional effectiveness and efficiency. Thus, the program aims to underpin an ongoing reform in this area, strengthening conditions to enable the SIN to generate revenue increases that would justify a more costly institutional framework than the traditional one. The Government of Bolivia has the firm political will to persevere with the SIN institutionalization process.

4.3 The panorama is more complex in the **pensions area**, since correcting the dynamics discussed above requires adoption of a cautious strategy. Seven years after the structural reform approved in 1996, three strategic alternatives are possible. The first is to abandon the 1996 reform and revert to a generalized PAYG system. The second option is to carry out a parametric reform of the system. The third possibility is to identify, isolate and correct the immediate sources of the fiscal cost, and to lay foundations for a permanent institutional framework that would serve to contain expenditure pressures.

4.4 The first alternative is not considered viable for two main reasons: firstly, it is set in a context of structural reforms undertaken seven years ago, with major political costs that reflect the government's commitment to modernize the economic system; and secondly there are ongoing contractual obligations both with private pension providers and with savers, involving an implicit contract that their personal saving will produce a pension in the future. In addition, there is a complex arrangement in which government liabilities (treasury bills) are simultaneously AFP assets, while affiliates' contributions paid into the system represent AFP liabilities on the other side of the balance sheet. Unraveling this scheme would mean seeking alternative and immediate sources of financing for the fiscal deficit, breaching contracts and thereby generating legal uncertainty, and returning savers' deposits. Embarking upon a strategy of this type would therefore be unviable and highly risky. The second option would mean carrying out a parametric reform of the PAYG system, which is not considered politically viable in Bolivia in 2003. Nonetheless, it is perfectly feasible to establish bases to identify the options for parametric reform and its possible costs in the future.

4.5 The third alternative, which is the only one considered technically and politically viable, pursues three gradual effects. Firstly, to identify, isolate and correct the main sources of the increase in expenditure in the short-term, generating savings that could amount to more than 1% of GDP; secondly, to identify the sources of expenditure pressure in the medium-term, by designing and using modern actuarial models, in order to more precisely identify the range of possible parametric reforms; and thirdly, to establish an institutional framework that eases tensions and reduces pressure for fraud, ensuring that any expenditure reductions achieved are lasting, and establishing the technical bases for implementing a parametric reform of the PAYG system as and when political conditions permit.

4.6 The *strategy adopted*, and the short, medium- and long-term vision of pensions in Bolivia is set in this context. In the short-term covering the next two years, actions are essential in three fields: firstly, a deepening of institutional reform in tax administration, providing it with a similar structure to the pensions area. Only with adequate institutional capacity will it be possible to establish the first line of defense against expenditure, namely the institutional one. Secondly, immediate results could be generated on expenditure containment by implementing a policy to reduce fraud and arrears, which is economically and politically feasible in 2003. Thirdly, it is important to establish technical bases to make it possible to analyze the feasibility of parametric reforms (changing the retirement age, minimum and maximum pensions, criteria for recognition of survivorship, and so forth), if the situation permits and the necessary political will exists. This would guarantee fiscal sustainability to the PAYG system in the medium-term.

4.7 In this context, although the program helps to reduce the deficit by up to 1% of GDP, and establishes the necessary institutional framework to make this reduction permanent, it fails to tackle a more profound reduction of expenditure in the PAYG system. This can only be addressed with a parametric reform of medium and long-term horizon.

B. Program benefits, risks, impact and evaluation

4.8 The proposed program has four main benefits. In the first place, it generates a reduction in the deficit of between 0.4% and 1% of GDP. Secondly, it underpins institutional reforms that have made professional management possible in the SIN. Thirdly, it establishes a modern institutional organization for the pensions area of the PAYG system. Lastly, and as a subproduct of the above, it establishes technical conditions to enable the Government of Bolivia to carry out parametric reforms in the future, when political conditions allow.

4.9 As noted in the program description, the main objective is to strengthen fiscal sustainability in Bolivia. The expected outcome or impact of the program's actions in this area consists of a **permanent** reduction in the annual fiscal deficit of between 0.4% and 1% of GDP (between approximately US$32 million and US$80 million per year). The way this reduction is distributed is shown in the adjacent table. The baseline for each of the variables, together with the corresponding information sources and means of verification are given in Annex I-2B.

Expected impact of deficit reduction	
Measures	***Range***
Efficiency of revenue collection	0.2 - 0.4%
Control of fraud	0.1 - 0.3%
Control of arrears	0.02 - 0.05%
De-indexation	0.1 - 0.3%
Total	**0.42 - 1.05%**

4.10 In addition to this impact, another aim is to strengthen the institutional framework of tax administration and to restructure pensions institutions, all within three years. Achieving these institutional outcomes in both administrations is seen as crucial for making deficit reduction **permanent**. Lastly, by using modern actuarial modeling instruments, the institutional strengthening process in the pensions area will lay technical foundations for simulating the medium-term effect of any future parametric reform.

4.11 There are major risks attached to the program, particularly relating to the reforms' economics. The viability of the reform of PAYG systems depends on the clarity with which the individuals standing to lose are identified, and on their ability to mobilize political support in defense of their interests; and the simultaneous generation of gainers through parallel reforms. In the past, the relatively rapid reform of the pension system in Bolivia can be explained, firstly, by the fact that the government at the time had an ample parliamentary majority; secondly, by the compensatory effect produced by the emergence of new savers in the individual capitalization system, together with *Bonosol* beneficiaries; and, thirdly, by the lack of precision in many of the specific effects of the reform, resulting from a transition that has generously accommodated the numerous groups that might have considered themselves harmed.

4.12 The situation today is very different, because of insufficient parliamentary support and the scant possibilities of identifying parallel beneficiaries to compensate the those standing to lose from rationalization of the PAYG system. For this reason, a parametric reform of the PAYG system in a legislative package that would allow drastic expenditure cuts to be made is not considered politically viable. The project aims to make minor policy corrections, but is essentially focused on administrative rationalization and control of fraud, which, without clearly specifying those standing to lose and being executed gradually through time, dilutes the sources of potential resistance by affected parties. Nonetheless, given the potential social extent of the fraud and the role played by intermediaries, organized resistance to the proposed measures cannot be ruled out. The application of new pensioner communication and assistance policies is considered fundamental for counteracting these risks. The parallel technical cooperation grant will finance these dissemination and communication activities.

4.13 In addition, the strengthening of tax and pension administrations is at risk from the politicization of the public sector in Bolivia and a lack of professionalization among its staff. This problem is less worrying in the case of tax administration where modernization has taken place through an institutional mechanism supported by the World Bank and the IDB. The risk in this area relates to the sustainability of the mechanism once program funding has come to an end. To mitigate this risk, the program establishes conditions that seek institutional consolidation.

4.14 The risk is greater in the case of the Pensions Administration, given the weakness of the institution and the fact that its human resource policies have traditionally suffered from cronyism. This relates to its nature as an instrument consistent with the political economy of the reform described above. In this case, the program aims to establish an organizational regime to legitimize the institutional framework through professionalization, transparency and results-based management. Making technical cooperation funds available to sustain the mechanism is seen as a key to neutralizing this risk.

4.15 Lastly, given the program's high impact and the level of risk in its execution, the Bank and the government have agreed to conduct an ex post evaluation of the program and technical cooperation activities. This will be financed using the proceeds of the parallel technical cooperation, as mentioned in paragraph 3.14 of this document.

POLICY LETTER

In order to help the national government in its effort to reduce the fiscal deficit by increasing revenues and containing and cutting public spending on pensions, the Inter-American Development Bank (IDB) has suggested the possibility of implementing a sector program to support fiscal sustainability.

The loan involved would be an unrestricted, fast-disbursing loan in the amount of US$63 million, to be disbursed in three tranches over a period of at least 18 months.

I. MACROECONOMIC SITUATION AND FISCAL ADJUSTMENT

The large fiscal deficit is one of the main problems to be resolved by the current government and is therefore one of the priorities in negotiations with the international financial community. The 2001 deficit was already high (7% of GDP), and continued to climb to 8.7% of GDP in 2002.

The fiscal deficit has been increasing over the last few years, primarily as a result of pension reform implementation. The nonfinancial public-sector (NFPS) deficit rose from 1.9% of GDP in 1996, the year before the reform was implemented, to 3.7% of GDP in 2000 and 7% in 2001. In the 1997-2000 period, the cost of the reform has been practically equivalent to the total NFPS deficit since, without those costs, the fiscal accounts were balanced, and even showed a slight surplus in 1999 and 2000. In 2001 the deficit without pensions was at –2.2% of GDP, because of the impact of the economic slowdown on tax collections. This situation worsened further in 2002, the deficit without pensions having reached –3.6%.

It is obvious that the higher deficit was due both to falling revenues and increased expenditures. Fiscal revenues contracted from 31.1% of GDP in 2001 to 28.4% of GDP in 2002. Outflows, not counting the cost of pension reform, also contracted, but at a slower rate—from 33.2% of GDP in 2001 to 32.1% of GDP in 2002.

The explanation for the drop in revenues is the contraction in taxes on hydrocarbons, which fell from 5.2% of GDP in 2001 to 4.7% in 2002. The postponement of internal fuel price readjustments is behind this. Tax revenues increased slightly, from 13.1% to 13.5% of GDP over the same period.

From the expenditures side, the increases in the cost of pensions and in capital expenditures stand out. Pensions increased again in 2002, from 4.8% of GDP in 2001 to 5.1% in 2002, because the higher exchange rate devaluation resulted in a higher nominal cost, since pensions are indexed to variations in the price of the currency. Investments rose from 8.5% of GDP to 8.8% in 2002.

NFPS Balance Sheet
(Percentage of GDP)

	1996	1997	1998	1999	2000	2001	2002
TOTAL REVENUES	**30.4**	**29.5**	**31.2**	**32.6**	**33.8**	**31.1**	**28.4**
CURRENT REVENUES	**28.1**	**28.1**	**29.8**	**30.7**	**31.6**	**28.7**	**26.1**
TAX REVENUES	11.5	12.9	14.1	13.3	13.6	13.1	13.5
INTERNAL REVENUE	10.3	11.3	12.5	11.9	12.2	11.9	12.4
CUSTOMS REVENUE	1.2	1.4	1.5	1.3	1.3	1.1	1.1
MINING ROYALTIES	0.1	0.1	0.1	0.1	0.1	0.1	0.1
TAXES ON HYDROCARBONS	0.1	2.9	4.7	4.6	5.1	5.2	4.7
SALE OF STATE-OWNED ENTERPRISES	11.3	7.4	6.1	6.7	8.3	6.0	3.6
CURRENT TRANSFERS	1.3	0.7	0.8	0.9	0.8	0.8	1.1
OTHER CURRENT REVENUES	3.8	4.2	4.1	5.2	3.7	3.6	3.1
CAPITAL INFLOWS	**2.4**	**1.4**	**1.4**	**1.8**	**2.2**	**2.4**	**2.3**
TOTAL EXPENSES	**32.4**	**30.3**	**31.8**	**31.9**	**33.1**	**33.2**	**32.1**
CURRENT EXPENSES	**24.2**	**23.0**	**24.8**	**24.8**	**26.0**	**24.7**	**23.3**
PERSONAL SERVICES	10.7	10.5	10.2	10.0	9.5	9.8	10.0
GOODS AND SERVICES	5.6	7.0	8.6	8.9	10.7	8.6	6.4
INTEREST ON FOREIGN DEBT	1.7	1.5	1.2	1.2	1.3	1.1	1.1
INTEREST ON DOMESTIC DEBT	0.5	0.1	0.2	0.4	0.6	1.0	1.1
CURRENT TRANSFERS	3.4	1.7	2.5	1.7	1.6	1.9	1.5
OTHER CURRENT EXPENSES	2.4	2.3	2.0	2.5	2.3	2.3	3.2
UNIDENTIFIED EXPENDITURES	-0.1	0.0	0.1	0.2	0.1	-0.1	0.1
CAPITAL OUTFLOWS	**8.2**	**7.2**	**7.0**	**7.1**	**7.1**	**8.5**	**8.8**
SURPLUS (DEF) WITHOUT PENSIONS	**-1.9**	**-0.8**	**-0.6**	**0.6**	**0.8**	**-2.2**	**-3.7**
PENSIONS	0.0	-2.5	-4.0	-4.1	-4.5	-4.8	-5.1
OVERALL SURPLUS (DEFICIT)	**-1.9**	**-3.3**	**-4.6**	**-3.5**	**-3.7**	**-7.0**	**-8.7**

Source: Ministry of Finance

Fiscal deficit financing. In the 1999-2000 period, deficit financing came primarily from external sources that have covered, on average, 60% of the deficit, while internal sources have covered the remaining 40% on average. However, internal financing expanded significantly in 2001, to 3.9% of GDP. In 2002, the deficit was mostly financed from external sources, especially because of increased disbursements, which rose from 4.6% of GDP in 2001 to 7.3% of GDP in 2002. The share of internal sources in deficit financing dropped from 3.9% of GDP in 2001 to 2.5% of GDP in 2002. This was due to the placement of public securities, which had expanded by 3.5% of GDP in 2001, became more difficult in 2002, with a contraction of –0.8% of GDP in 2002. It is important to highlight, however, that the Central Bank's credit to the National Treasury expanded by 1.7% of GDP in 2002.

One of the most important sources of internal financing was the placement of Treasury bonds in the pension funds—an average of US$150 million per year (about 1.7% of GDP). This policy was maintained in 2002. The placement of public debt has meant that a significant portion of the resources in the pension funds were raised by the Treasury. Thus, despite the suitability of these resources to finance long-term investments, they could not be used to revitalize the productive sector.

The build-up of public internal debt to finance the deficit has also contributed to its increase, because of the resulting larger interest payments. The payment of interest on the public internal debt climbed from US$64 million in 1997 (0.8% of GDP) to US$115 million in 2002 (1.6% of GDP).

For its part, public external debt increased from 3.1% of GDP in 2001 to 6.2% of GDP in 2002. This increase was due to higher disbursements of external financing that year. Higher disbursements from development lines and debt alleviation under the HIPC initiative also contributed to the increase in external financing.

II. FISCAL ADJUSTMENT AND PROGRAM WITH THE IMF

A stand-by arrangement with the IMF was concluded in April which calls for cutting the fiscal deficit from 8,7% of GDP in 2002 to 6.5% in 2003. The government's fiscal policy involves measures related to revenues and expenses, such as eliminating tax exemptions, expanding the tax base, restructuring the Executive Branch, and reducing the cost of pensions.

In order to improve the tax base and cope with the growing cost of pensions, the government's agenda includes legislative changes, restructuring of current regulations, institutional strengthening, and transparency. To achieve the necessary fiscal adjustment and make it sustainable over time, implementation of these measures and the monitoring thereof will be supported by the sector loan with the IDB

III. TAX ADMINISTRATION AND THE IDB SECTOR PROGRAM

In order to guarantee that internal tax collection targets established in the General Budget of the Nation are achieved, the Office of the Deputy Minister for Tax Policy, as the fiscal authority, is committed to carrying out measures to adjust tax regulations and programs to strengthen tax administration, which are indicated below:

New Bolivian Tax Code

For purposes of implementing the new tax framework establishing clear rules regarding the legal-tax relationship, simplified, computerized, and general procedures, and in particular the application of a custodial penalty, a draft Bolivian Tax Code Law has been presented for processing by the Legislative Branch. The reform measure also includes improvements in the General Customs Law, creation of the Tax Superintendency, and incentives to pay taxes.

For purpose of implementing the new code, its transitory provisions include the establishment of exceptional treatment for the regularization of tax accruals, to forgive interest and penalties and allow overdue taxes to be paid over a period of up to five years, with a two-year grace period.

There are also transitory provisions referring to the updating of the current Internal Revenue Service registry and the implementation of a new national taxpayer registry, to enable the Tax Administration to take out taxpayers and/or authorities that do not conduct taxable economic activities at this time.

For the new Tax Code to have full force and effect and to complement other procedural and clarifying aspects, the Executive Branch needs to draft the respective regulations.

Amendments to Law 843

The amendments to tax regulations involve some adjustments that are currently causing distortions in the tax system. In this regard, in the context of the tax policy, the proposed law intends to apply the following measures to the following taxes:

Business profit tax

Some adjustments are being made to this tax to make it more effective and eliminate certain distortions in its application; in this regard:

- Civil corporations are covered under this tax.
- Civil associations are covered under this tax.
- The tax treatment of nonprofit institutions and foundations is clarified.
- The tax treatment on delivery of services from outside the country is clarified.
- The exemption for those providing financial intermediation services and other regulated services is eliminated.

Motor vehicle property tax

Currently the tax base for payment of the vehicle property tax is defined based on the self-valuation system with tables of values, depreciation, and other technical factors annually established by the Executive Branch by express resolution.

The minimum residual value drops from 16.8% to 10.7%.

Tax on transactions

The sale and purchase of installments of capital stock in limited companies are exempted.

Airport departure tax for travel abroad

The established measure aims to generalize its application to cover residents and nonresidents alike, have its value included in the airfares, and update the tax rate to Bs 150.

Special tax on hydrocarbons and their byproducts

Alternative fuel products involving blending, platforming, and others, not expressly considered in the list attached to Law 843, in some cases lead to avoidance practices, which represent unequal treatment in the application of this tax compared with products resulting from the refining process.

This gap makes it necessary to amend Articles 109, 112, and 113 of Law 843, clarifying this tax and making other products used—such as fuels obtained through any production, mixing, or refining process—taxable.

Tax compliance of oil companies

In addition, the coverage and tax compliance of oil companies will be examined in detail. The topics are:

- Business profit tax (IUE). Supreme Decree 24051, which regulates this tax, needs to be supplemented in the following areas, among others: the obligation on the part of the oil producers to present their cost structure; modification of the depreciation method for oil wells; indefinite compensation for losses; and lack of legislation on transfer prices.

- Tax on profits of foreign beneficiaries (IUE-BE). The assumption is that oil production profits are being remitted through payments for services or procurement of goods abroad.

- Excess profit tax (SURTAX). The structure of this tax needs to be reviewed since it allows deductions that limit the coverage of the tax, and the formula to update the value on net income per extractive operation, changed.

- Value added tax (IVA). The assumption is that oil blocks are transferring tax claims, which leads to some companies claiming them inappropriately.

- Special tax on hydrocarbons and their byproducts (IEHD). This tax should not act as a price adjustment mechanism, which has been the case to date. It is recommended that a study be conducted on the methodology for calculating end-user prices, especially for the profit margins of refining and marketing agents.

- Value added tax (IVA). The tax debit is calculated on the invoiced total excluding the IEHD, while the tax credit claimed by the wholesale distributor is the result of applying the VAT share to the invoice total, i.e., including the IEHD.

- Business profit tax (IUE). There is a need for refineries to present their cost structure like producers do, in order to properly determine this tax and the refinery margins.

- Turnover tax (IT). The wholesale and retail distributors pay the IT on the value of their sales, deducting what they paid the refineries and the fee paid to storage and bottling companies. This provision contradicts Article 74 of Law 843, which provides that the tax will be determined on the basis of gross income due.

- It would be advisable to assess the current pricing system for subsequent modification.

- Sector firms should be monitored for purposes of fiscal planning.

Once the amendments to Law 843 have been approved and promulgated, the Executive Branch will issue decrees regulating the respective taxes.

Progress with institutional reform

With Tax Administration reform in place (Law 2166), the objective of which is to have a modern, efficient, and effective tax administration, the process of institutionalizing the human resource component is moving towards culmination, which is making it possible to hire qualified staff, chosen without political interference and with discretional authority as to appointments.

The important steps to improve tax administration are focused on the following points:

- Processes will be reengineered to improve administrative systems qualitatively and quantitatively.

- Taxpayer categories will be reestructured into: main taxpayers, large taxpayers, and the rest.

- Taxpayers will be registered again to ensure that the registry is up to date, transparent and reliable until the end of this fiscal year.

- Taxpayers' demand deposit accounts will be adapted to establish reliable control of debts and payments recorded, with up-to-date information on credits and debits generated by the taxpayer and the administration.

- A billing system will be established to avoid cloning and forgeries.

- A new auditing approach will be adopted under which more efficient control processes will be applied and a larger number of taxpayers will be covered under audit plans.

- An information technology plan will be put in place. First a detailed diagnostic study of existing information systems will be conducted. Then short- and medium-term actions will be undertaken to set up modern information systems. External financing will be required for equipment.

- Taxpayer services will be provided via the Internet

Technical assistance for tax administration

The SIN is receiving technical assistance through the institutional reform project that administers World Bank resources and the SIN PROFISI institutional strengthening program that administers Inter-American Development Bank resources.

The results achieved under the institutional reform process have been satisfactory. The human and technical potential still needs to be developed more fully however. The national government intends to provide significant support for Tax Administration strengthening, thereby guaranteeing the tax resources necessary to cover public spending.

IV. PENSION POLICY AND THE IDB SECTOR PROGRAM

Realignment and containment of spending under the pension system and the contributions compensation program

The transition of the pension system to the SSO took place in a context of lack of legal and financial discipline, favoring regulatory dispersal, low quality of information on spending, and nonfulfillment of obligations, which meant a larger increase in spending than was forecast and lack of equity in the level of protection.

In order to resolve this problem, it is necessary to comply with reform estimates, consider the transition period over and close the system, get an exact grasp of spending, and speed up debt collection.

The difficulty of the transition process has generated tensions. There is pressure to keep the pay-as-you-go pension system open and maintain the regulatory dispersal (close to 50 regulations in force), which facilitates the lack of discipline, with regard to which the government should: rationalize and simplify existing regulations, which pursuant to the rules established under Law 1732 through a supreme decree:

(i) Prohibit the addition of bonds or change in pensions, except to update the value established by law;

(ii) Ratify the effective and real closing of the pension system as of 31 December 2001; and

(iii) Systematize the body of regulations.

The information on spending behavior and the system's future spending commitments is inconsistent and unreliable, making planning and control difficult. Future spending commitments for pensions and contribution compensation rights need to be quantified, and corrective measures adopted to prevent deviations between anticipated and actual spending.

For a diagnostic assessment of the current and future situation, the actuarial model and actuarial reports on pension and Contribution Compensation spending—tools for the control of spending—need to be presented to the government for approval.

The government needs an action plan and timetable for implementing measures to correct the negative results of the actuarial model.

The existing pension revaluation system is inconsistent with the system's capacity. The current revaluation system therefore needs to be replaced with another based on the Housing Development Unit, through a law amending Law 1732 and its regulatory decrees.

Cutting spending through management

The dynamics of the transition model have produced incentives to commit fraud to obtain pensions; the control systems are weak, and it is therefore essential to implement a program to combat pension fraud with anticipated total savings of Bs 150 million by the date of the third disbursement.

Business and government contributions in arrears have not been paid. The estimated debt for nonpayment of contributions is equal to almost one year of system outlays. Debts to the system remain unrecovered.

To improve the situation, incentives for businesses to make good on the unpaid contributions need to be provided through a supreme decree that includes:

(i) The general conditions of the agreements and payment plans to be signed in agreements with the businesses in arrears;

(ii) Provisions for penalties in case of noncompliance with the payment plans or, in their absence, measures to prevent businesses from contracting with the State; and

(iii) The sending of information on the businesses in arrears to the banking system's risk center.

In addition, it is necessary to recover the debt accrued through a program to combat arrears that includes:

(i) A detailed financial statement of the debt in arrears; and

(ii) A plan for the signature of recognition agreements and payment of the debt in arrears consistent with debt recovery targets.

At this time there is no adequate information for settlement and divestiture of assets because of: (i) titling flaws and improper occupation status; (ii) limited information on the accounting situation; and (iii) complexity of divestiture procedures, which means it is necessary to improve information and increase transparency on the current status and economic-financial balance of the assets of the former complementary funds.

Resolving the problem will require:

(i) The presentation of a detailed report, endorsed by the Ministry of Finance, that includes the balance sheet status of all the complementary funds;

(ii) The hiring of a consulting firm to draw up a consolidated balance sheet;

(iii) Presentation of the consolidated balance sheet and a divestiture plan.

Institutional strengthening of the area

The institutional framework of Bolivia's pension system is currently weak, particularly in terms of planning and system organization, recognition and management of benefits, and political and administrative control of the managing entity. It is therefore vitally important to establish a legal and institutional framework under which spending can be controlled and the transparency and legal security of the pension system can be strengthened.

To improve this situation, a supreme decree will need to be approved that contains at least the following:

(i) Assignment of responsibility over the pension system to the Office of the Deputy Minister for Budget, including the functions of planning, organization, and control of the managing entity;

(ii) Establishment of a Pensions Administration under the Office of the Deputy Minister for Budget;

(iii) Establishment of a national deconcentrated pension service, attached to the Office of the Deputy Minister for Budget, that exclusively assumes the functions of management of the pay-as-you-go pension system, instead of the Pension Division;

(iv) Definition of the relationship between the Deputy Minister for Budget and the National Pension Payments Office (SNRSR) through a management contract that includes performance indicators and institutional strengthening;

(v) Technical support from the Superintendency of Pensions, Securities, and Insurance to the Office of the Deputy Minister for Budget to perform oversight functions through a technical assistance contract.

The institutional strengthening of the NSRSR is essential and will require a management contract between the Office of the Deputy Minister for Budget and the SNRSR that makes it possible to fulfill the objectives of the program and contains targets in the following areas as a minimum:

(i) Human resource plan in the context of the Civil Service Statute;

(ii) Reengineering of critical processes;

(iii) Streamlining of the payment circuit through the banking system;

(iv) Digitizing of the documentary foundations of management; and

(v) Execution timetable.

[original letter signed]

POLICY MATRIX
SECTOR PROGRAM TO SUPPORT FISCAL SUSTAINABILITY (BO-0213)

	Objective-final impact	Tranches		
		First	Second	Third
Macroeconomic framework. Instability of macroeconomic framework adjusted	Macroeconomic stability	Maintenance of an appropriate policy framework that is consistent with the program's objectives.	Maintenance of an appropriate policy framework that is consistent with the program's objectives	Maintenance of an appropriate policy framework that is consistent with the program's objectives

Component 1: Tax administration				
Problem	Objective-final impact	Tranches		
		First	Second	Third
1.1. Limited efficiency of tax administration	1.1. Annual increase in tax collections of 3% in real terms, stemming exclusively from administrative improvements, excluding the impact of regulatory changes (rates) and economic growth	• Contracting of new SIN staff completed • Evidence of SIN budget allocation for at least Bs 102 million in 2003	• At least 70% progress of indicators set out in the Appendix to the Annex on means of verification • Evidence of transfers to the SIN of amounts agreed for 2003, and budget of Bs 115 million for 2004	• At least 70% progress of indicators set out in the Appendix to the Annex on means of verification • Evidence of transfers to the SIN of amounts agreed for 2004

Component 2: Pension policy: realignment and containment of spending under the PAYG system and the contributions compensation program				
Problem	Objective-final impact	Tranches		
		First	Second	Third
2.1. The transition process has made it possible to keep the pay-as-you-go (PAYG) system open, with a wide range of regulations, leading to a lack of discipline.	2.1. Rationalization and simplification of existing regulations	Approval of the supreme decree ratifying the closing of the PAYG pension system	Approval of a supreme decree systematizing the body of legislation.	
2.2. The data on spending behavior and the system's future spending commitments are inconsistent and unreliable, making planning and control difficult	2.2. Quantification of the future spending commitments involving pensions and contribution compensation rights, and adoption of corrective measures to prevent deviation between budgeted and actual spending	Presentation of the government's proposed actuarial model and of two preliminary actuarial reports	Government approval of tools and timetable for spending control in accordance with the criteria set forth in the means of verification annex	Implementation of corrective measures pursuant to the action plan and timetable approved under the second tranche

Component 2: Pension policy: realignment and containment of spending under the PAYG system and the contributions compensation program				
Problem	**Objective-final impact**	**Tranches**		
		First	**Second**	**Third**
2.3. Pension revaluation system is not consistent with system capacity	2.3. Replacement of the current revaluation system with one based on housing development units (UVFs)	• Presentation and approval of legislation that sets the revaluation of pensions to the UVFs		• Presentation of evidence of savings on pensions as a result of reindexation (estimated US$20 million)

Component 3: Management programs to reduce pensions expenditure				
Problem	**Objective-final impact**	**Tranches**		
		First	**Second**	**Third**
3.1 The dynamics of the transition model has produced incentives to commit fraud to obtain pensions. The control systems are weak	3.1. Implementation of a program to combat fraud in this area	• Presentation of the plan to combat fraud, with total savings of Bs 150 million by the third disbursement	• Update of the plan to combat fraud • Implementation of the plan with savings of Bs 65 million	• Implementation of the plan with cumulative savings of Bs 150 million
3.2. Business and government contributions in arrears have not been paid. The estimated debt involving unpaid contributions is almost equal to the value of one year of system spending. System debts remain unrecovered.	3.2. Provide incentives for the payment of contributions owed by businesses through a supreme decree and recover the accrued debt through a program to combat arrears	• Presentation of a supreme decree • Presentation of the program to combat arrears	• Approval of the supreme decree • Signature of agreements covering at least 10% of the total debt • Recovery of at least Bs 8 million from the debt in arrears	• Signature of agreements covering at least a cumulative 20% of the total debt • Recovery of Bs 20 million from the debt in arrears
3.3. Lack of data for the settlement and divestiture of the assets of the complementary funds	3.3. Improvement of the data on the current status and economic-financial balance of the assets	• Presentation of a report on the balance sheet status of the complementary funds	• Contracting of a consulting firm to draw up the consolidated balance sheet	• Presentation of the consolidated balance sheet and divestiture plan

Component 4: Institutional reform of the PAYG pension system				
Problem	**Objective-final impact**	**Tranches**		
		First	**Second**	**Third**
Weak institutional framework of the pension system in the areas of planning and system organization, recognition and management of benefits, and political and administrative control of the management body	4.1 Establishment of an institutional and legal framework to control spending and strengthen transparency and legal security of the pension system	• Approval of a supreme decree reorganizing the institutional structure of the PAYG pension system	• Ministerial decision approving the organizational structure and SNRSR payroll • Signature of contract for technical support in the area of supervision between the Office of the Deputy Minister for Budget and the SPVS	
	4.2. Institutional strengthening of the National Pension Payments Office (SNRSR)		• Signature of management contract between Office of the Deputy Minister for Budget and the SNRSR	• Fulfillment of SNRSR restructuring goals, set out in management contract

POLICY MATRIX-MEANS OF VERIFICATION
SECTOR PROGRAM TO SUPPORT FISCAL SUSTAINABILITY (BO-0213)

COMPONENT/POLICY MEASURE	MEANS OF VERIFICATION	AGENCY RESPONSIBLE
FIRST DISBURSEMENT (estimated June 2003)		
Macroeconomic stability		
Appropriate policy framework consistent with program objectives is maintained	Copy of policy letter Copy of current stand-by arrangement with the IMF	Ministry of Finance Ministry of Finance
Component 1: Tax administration		
1.1 Finalization of basic process for hiring new SIN staff in the context of the ARI.	SIN Board report providing evidence that the basic process for filling 505 new contract positions has been finalized	Internal Revenue Service
1.2 Evidence that SIN resources have been budgeted, including: (i) minimum of Bs 102 million in 2003 to guarantee current operation of the institution, technological modernization, and fulfillment of indicators established in the appendix to Annex 1-2B; and (ii) indication of the source of funds committed and specific activities that will be financed therewith	Ministry of Finance decision containing certification that Bs 102 million have been allocated in the 2003 budget, as well as sources of financing of the amount	Ministry of Finance
Component 2: Pensions policy: realignment and containment of spending under the PAYG pension system and the contributions compensation program		
2.1 Approval of a supreme decree which, pursuant to the provisions of Law 1732: (i) starting on the date of the decree, prohibits the addition of bonuses or the changing of pensions, except to update the value as established by law; and (ii) ratifies the effective and actual closing of the entire PAYG pension system beginning on 31 December 2001	Supreme decree approved	Ministry of Finance
2.2 Presentation of the actuarial model proposed by the government and of two preliminary actuarial reports on spending on pensions and contribution compensation, respectively	a) Report on actuarial model proposed by the government b) Preliminary actuarial report on spending on pensions c) Preliminary actuarial report on spending on compensation rights	Ministry of Finance
2.3 Presentation and approval of Law 2434 that amends Article 57 of Law 1732 whereby the revaluation of pensions is linked to the UFVs	Law 2434 approved with the amendment of Article 57 of Law 1732	Ministry of Finance

COMPONENT/POLICY MEASURE	MEANS OF VERIFICATION	AGENCY RESPONSIBLE
2.4 Approval of the supreme decree containing implementing regulations of Law 2434	Supreme decree approved	Ministry of Finance
Component 3: Management programs to reduce expenditures		
3.1 Presentation of plan to combat fraud with total expected savings of Bs 150 million by date of third disbursement	Report containing the plan to combat fraud, with a target of cumulative savings of Bs 150 million (from June 2003 to December 2004) including quarterly targets	Ministry of Finance
3.2.1 Presentation of supreme decree that provides an incentive for contributions owed by businesses to the public pension system	Supreme decree presented includes: (i) the general terms and conditions of agreements and payment plans to be signed with businesses in arrears; and (ii) penalties for noncompliance with payment plans or, in their absence, those businesses will be excluded from state contracts and the banking system risk center will be notified	Ministry of Finance
3.2.2 Presentation of the program to combat arrears that includes: (i) a detailed financial statement of debt in arrears; and (ii) a plan for the signature of agreements for recognition and payment of arrears on a quarterly basis consistent with the debt recovery targets included under the second and third tranches	Report containing the plan to combat arrears, including: (i) the detailed financial statement of the debt in arrears as of June 2003; (ii) a plan for the signature of agreements for recognition and payment of arrears consistent with the recovery targets; (iii) target of signed agreements representing at least 20% of the debt (June 2003 to December 2004) detailed in the financial statement; and (iv) debt recovery targets in the amount of Bs 20 million (June 2003 to December 2004)	Ministry of Finance
3.3 Presentation of a detailed report, endorsed by the Ministry of Finance, that includes the balance sheet status of all complementary funds	Report on the balance sheet status of complementary pension fund assets, presented by the Ministry of Finance	Ministry of Finance
Component 4: Institutional reform of the area		
4.1 Approval of a supreme decree that contains at least the following: (i) assignment of responsibility for the PAYG pension system to the Office of the Deputy Minister for Budget, including planning, organization, and control of the management body; (ii) creation of a Pension Payments Administration in the Office of the Deputy Minister for Budget; (iii) the creation of a deconcentrated national pension service, attached to the Office of the Deputy Minister for Budget, that *exclusively* assumes the PAYG system's management functions, replacing the Pension Division; (iv) definition of the relationship between the Office of the Deputy Minister for Budget and the SNRSR through a management contract that includes performance results and institutional strengthening; and (v) technical support from the	Supreme decree approved	Ministry of Finance

COMPONENT/POLICY MEASURE	MEANS OF VERIFICATION	AGENCY RESPONSIBLE
Superintendency of Pensions, Securities, and Insurance to the Office of the Deputy Minister for Budget for performance of the supervision functions, through a technical assistance contract		

COMPONENT / POLICY MEASURE	MEANS OF VERIFICATION	AGENCY RESPONSIBLE
SECOND DISBURSEMENT (estimated December 2003)		
Component 1: Tax administration		
1.1 At least 70% progress towards indicators of SIN efficiency established in the Appendix to Annex 1-2B, calculated in accordance with the formula set out in said annex	Report approved by the SIN Board with evidence that the Appendix to Annex 1-2B targets have been attained	Ministry of Finance
1.2 Evidence of transfers to the SIN of the amounts agreed for 2003 (target: at least Bs 111 million), and allocation to the SIN's budget in the amount of Bs 115 million for 2004	a) Report of the Office of the Comptroller General of the Nation containing certification of the transfer to the SIN of at least Bs 102 million earmarked in the 2003 budget b) 2004 budget bill presented to the national Congress	Office of the Comptroller General of the Nation Ministry of Finance
Component 2: Pension policy: realignment and containment of spending under the PAYG pension system and the contributions compensation program		
2.1 Approval of a supreme decree to systematize the body of regulations involving the public pension system	Supreme decree approved and published	Ministry of Finance
2.2 Government approval of the following tools to control spending: (i) actuarial model; (ii) final actuarial reports on pensions and contributions compensation; (iii) identification of corrective measures to be adopted and their quantification based on the actuarial reports; and (iv) approval of an action plan and timetable for implementation	Ministry of Finance decision approving: a) Actuarial model for the pension distribution system b) Final actuarial report on pensions spending c) Final actuarial report on compensation rights spending d) Report with corrective measures to be adopted e) Report with action plan to control spending and timetable	Ministry of Finance
Component 3: Management programs to reduce expenditures		
3.1.1 Update of the plan to combat fraud based on the progress in the institutional reorganization of the pension system	Updated report containing the plan to combat fraud, with a target of cumulative savings of Bs 150 million (June 2003 to December 2004 period)	Ministry of Finance
3.1.2 Implementation of the plan with actual savings of Bs 65 million	Office of the Comptroller General of the Nation report certifying savings of Bs 65 million over the June 2003 to December 2003 period	Office of the Comptroller General of the Nation
3.2.1 Approval of the supreme decree that provides incentive for the payment to the public pensions system of contributions owed by businesses	Supreme decree approved	Ministry of Finance
3.2.2 Signature of recognition agreements and payment of debt in arrears covering at least 10% of the total estimated debt in the financial statement included in the plan to combat arrears	Report of the SNRSR certifying that the agreements were signed (2003)	SNRSR and Office of the Comptroller General of the Nation

COMPONENT / POLICY MEASURE	MEANS OF VERIFICATION	AGENCY RESPONSIBLE
SECOND DISBURSEMENT (estimated December 2003)		
3.2.3 Recovery of at least Bs 8 million of debt in arrears recognized in the signed agreements, in accordance with the objectives of the plan to combat arrears	Report of the Office of the Comptroller General of the Nation certifying that at least Bs 8 million have been recovered over the June 2003 to December 2003 period from the debt in arrears	Office of the Comptroller General of the Nation
3.3 Contract with a consulting firm to draw up the consolidated balance sheet of the complementary funds	Contract signed by the Ministry of Finance and the consulting firm	Ministry of Finance
Component 4: Institutional reform of the area		
4.1.1 Ministry decision approving the organizational structure and staff of the SNRSR	Ministry of Finance decision	Ministry of Finance
4.1.2 Signature of the technical support contract for supervision between the Office of the Deputy Minister for Budget and the SPVS	Contract signed by the Office of the Deputy Minister for Budget and the SPVS	Ministry of Finance
4.2 Signature of the management contract between the Office of the Deputy Minister for Budget and the SNRSR that makes it possible to achieve the program's objectives. The contract will contain targets in the following areas, as a minimum: (i) human resource staffing plan in the context of the Civil Service Statute; (ii) reorganization of critical processes; (iii) rationalization of the payment circuit using bank accounts; (iv) digitization of management document bases; and (v) execution timetable	Management contract signed by the Office of the Deputy Minister for Budget and the SNRSR	Ministry of Finance

COMPONENT / POLICY MEASURE		MEANS OF VERIFICATION	AGENCY RESPONSIBLE
THIRD DISBURSEMENT (estimated December 2004)			
Component 1: Tax administration			
1.1	At least 70% progress towards indicators of SIN efficiency established in the Appendix to Annex 1-2B, calculated in accordance with the formula set out in said annex and agreed upon in tranche 2	Report approved by the SIN Board demonstrating that the targets set in the Appendix to Annex 1-2B have been met	Internal Revenue Service
1.2	Evidence of transfers to the SIN of the amounts agreed for 2004	Report of the Office of the Comptroller General of the Nation containing certification of the transfer to the SIN (2004) of the amount of at least Bs 115 million earmarked in the 2004 budget	Office of the Comptroller General of the Nation
Component 2: Pension policy: realignment and containment of spending under the PAYG system and the contributions compensation program			
2.2	Implementation of corrective measures pursuant to the action plan and timetable approved in the second tranche	Ministry of Finance report	Ministry of Finance
2.3	Presentation of evidence of savings on pension outlays in the amount of the difference between the exchange rate and the UFV (US$20 million per year of savings according to current macroeconomic forecasts)	Office of the Comptroller General of the Nation report containing certification of savings achieved (2003 and 2004)	Office of the Comptroller General of the Nation
Component 3: Management programs to reduce expenditures			
3.1	Implementation of the plan with actual cumulative savings of Bs 150 million	Office of the Comptroller General of the Nation report certifying savings of Bs 150 million in the June 2003 to December 2004 period	Office of the Comptroller General of the Nation
3.2.1	Signature of recognition agreements and payment of debt in arrears covering at least a cumulative 20% of the total estimated debt in the financial statement included in the plan to combat arrears	SNRSR report certifying the signature of agreements (2003)	SNRSR and Office of the Comptroller General of the Nation
3.2.2	Recovery of a cumulative amount of Bs 20 million of the debt in arrears recognized in the signed agreements, pursuant to the objectives of the plan to combat arrears	Report of the Office of the Comptroller General of the Nation certifying that at least Bs 20 million have been recovered over the June 2003 to December 2004 period, from the debt in arrears	Office of the Comptroller General of the Nation
3.3	Presentation of the consolidated balance statement and of a plan for the divestiture of the complementary pension funds	Audit report containing the consolidated balance sheet and a divestiture plan	Ministry of Finance
Component 4: Institutional reform of the area			
4.2	Fulfillment of targets to restructure the SNRSR, established in the management contract	Ministry of Finance report	Ministry of Finance

POLICY MATRIX
SECTOR PROGRAM TO SUPPORT FISCAL SUSTAINABILITY (BO-0213)

Annex: Indicators for fulfillment of Component 1 targets. Tax administration

Note: The definition, source of verification, baseline value, targets for the release of tranches 1 and 2 and the value, for reference purposes at this point, for tranche 3 are set out for each indicator. Then each indicator is assigned a level of priority: 1 (top), 2 (high), and 3 (mid-level), which will be taken into account in the evaluation of the level of fulfillment of the indicators based on the following criteria:

Indicator priority	Valuation	Number of indicators	Total
Top (1)	2	1	2
High	1	5	5
Mid-level	0.5	6	3
			10

(1) Indicator A: Impact of SIN management in terms of collections, which is given top priority, will have a variable valuation according to the following table:

Increase in efficiency	Valuation
Below 1%	0
1.5% to 2%	0.5
2% to 2.5%	1
2.5% to 3%	1.5
3% to 3.5%	2
3.5% to 4%	2.5
4% to 4.5%	3
Over 4.5%	4

Indicator:	**A. Impact of SIN management on collections**					
Target	**Means of verification**	**Baseline value**	**Target tranche 1**	**Target tranche 2**	**Referen. tranche 3**	**Priority**
Annual increases in tax collection of 3% in real terms (excluding the impact of regulatory changes, GDP growth, and inflation)	Monitoring of tax collection by the SIN's General Manager's Office	Budget of tax revenues for the 2003 fiscal year		Annualized increase of 3%	Annualized increase of 3%	1

Indicator: **B. Control of tax obligations** **B1. Reduced percentage of unpaid tax obligations**						
Target	**Means of verification**	**Baseline value**	**Target tranche 1**	**Target tranche 2**	**Referen. tranche 3**	**Priority**
Reduce the percentage of tax obligations not fulfilled by taxpayers. *Numerator*: Total obligations fulfilled *Denominator*: Total obligations to be fulfilled	SIRAT	1-IX-2002 36.3% obligations omitted overall / 18.3% for large taxpayers	Presentation of the draft legislation on the reorganization of the RUC approved and operational work to reorganize the RUC initiated	Approval of the new regulations and reduction of noncompliance by large taxpayers: omitted obligations below 12%	% reduction of noncompliance: large taxpayers: below 7%: Remainder: below 27%	2
Indicator: **B2. Inspections**						
Target	**Means of verification**	**Baseline value**	**Target tranche 1**	**Target tranche 2**	**Referen. tranche 3**	**Priority**
Increases in the number of tax audits performed compared to baseline *Numerator*: total number of audits performed over the period *Denominator*: total audits in the baseline period	SIRAT	December 2002/ number of audits per auditor: 33		Intensive training for audit staff in audit techniques and procedures 40 audits per auditor effectively conducted. Total number of audits: 8,600[1]	Number of audits effectively conducted per actuary: 48 Total number of audits*: 10,320	3
Indicator: **B3. Increase in effective collections stemming from audits**						
Target	**Means of verification**	**Baseline value**	**Target tranche 1**	**Target tranche 2**	**Referen. tranche 3**	**Priority**
Increase in effective collections stemming from audits with respect to the baseline	SIRAT	December-2002/ Effective collections per auditor Bs 163,000		Intensive training for audit staff in auditing techniques and procedures. Average effective collection per auditor: Bs 200,000 Effective collection[1]: Bs 43 million	Average effective collection per auditor: Bs 260,000 Total effective collection(*) Bs 55.9 million	2

[1] For a payroll of 215 auditors

Indicator: B4. Tightened control over hydrocarbons sector						
Target	**Means of verification**	**Baseline value**	**Target tranche 1**	**Target tranche 2**	**Referen. tranche 3**	**Priority**
Tighten control over hydrocarbons sector	SIRAT	2002/ Number of companies audited: 12	Reorganize and strengthen control over hydrocarbons sector	Intensive training for staff responsible for overseeing the sector Audit at least 18 businesses in the sector with particular attention to the more important ones from the tax collections standpoint	Audit at least 22 sector businesses, with particular attention to the more important ones from the tax collections standpoint	3
Indicator: B5. Enforced collection						
Target	**Means of verification**	**Baseline value**	**Target tranche 1**	**Target tranche 2**	**Referen. tranche 3**	**Priority**
Improve the results of enforced collection	SIRAT	2002/ Bs 45 million levied	Strengthen the area and reorganize the sector	Intensive training for staff in the central and local offices. Bs 60 million effectively levied (annualized)	Bs 84 million effectively levied (annualized)	2
Indicator: C. Taxpayer information and assistance services **C1. Expand taxpayer services through the Internet**						
Target	**Means of verification**	**Baseline value**	**Target tranche 1**	**Target tranche 2**	**Referen. tranche 3**	**Priority**
Expand taxpayer services through the Internet: incorporate most frequently asked tax questions, declaration forms, and help program. Receive taxpayer declaration forms over the Internet	Availability of services on SIN web page	No services available		- 700 questions included - 12 main forms included	- Help programs added - 1,000 questions included - Submission of declarations via internet: Compulsory for large taxpayers, voluntary for the remainder	3

Indicator: C2. Flexible system for receipt of taxpayer complaints and suggestions						
Target	**Means of verification**	**Baseline value**	**Target tranche 1**	**Target tranche 2**	**Referen. tranche 3**	**Priority**
Establishment of a flexible system for receiving taxpayer complaints and suggestions regarding SIN operation: open a specific mailbox for receiving taxpayer complaints and suggestions. Publicize it adequately.	Direct contracting and report of the office responsible	Does not exist	Identify the unit responsible (National Taxpayer Service Bureau or unit attached directly to the President of the SIN) and establish procedure for addressing complaints and suggestions. Dissemination of information on the new service in the media	Effective operation of service	Continuity of service	3

Indicator: D. Training						
Target	**Means of verification**	**Baseline value**	**Target tranche 1**	**Target tranche 2**	**Referen. tranche 3**	**Priority**
Increase and improve training for SIN staff	Report of the national human resources office	52 person-hours (permanent staff only)	Effective operation of the Training Unit Creation of a Training Committee Annual training plan for 2003 Preparation of teaching materials for training on main taxes and procedures	Provide at least 80 hours of training per permanent staff member at the executive level and for group I, II, III, IV professionals and technical staff at the operations level (annualized)	Maintain 80 hours of training for staff considered under tranche 2 (annualized)	2

Indicator: E. Information technology E1. Centralization of data and processes						
Target	**Means of verification**	**Baseline value**	**Target tranche 1**	**Target tranche 2**	**Referen. tranche 3**	**Priority**
Centralization of data and processes: create a consolidated database	Report from the General Manager's Office and the Information Technology Manager's Office Direct contracting	There are currently 17 district databases		Effective start of work necessary to centralize the databases. At minimum, the process of migration of applications and databases from Oracle 7.3 to 9i need to have begun	Have a single database	2

Indicator:	**E2. Expand SIRAT coverage**					
Target	**Means of verification**	**Baseline value**	**Target tranche 1**	**Target tranche 2**	**Referen. tranche 3**	**Priority**
Expand SIRAT coverage. Complete information technology support for the entire management process, incorporating enforced collection	Report from the information technology manager's office Direct contracting with SIRAT support	There is no module for enforced collection		Basic module for site visits and issuing of list of accusations	Complete module implemented	3
Indicator:	**F. Management information**					
Target	**Means of verification**	**Baseline value**	**Target tranche 1**	**Target tranche 2**	**Referen. tranche 3**	**Priority**
Management information system: statistics broken down by tax, type of taxpayer, regional subdivision, period, etc., periodically updated and with on line access	General Manager's Office and direct contracting with SIRAT	Scattered disorganized information that is difficult to manage		Identification of structure and content of management information	Module available	3

REIMBURSABLE TECHNICAL-COOPERATION FUNDING FOR A SECTOR PROGRAM TO SUPPORT FISCAL SUSTAINABILITY

(BO-0225)

EXECUTIVE SUMMARY

Requester:	Republic of Bolivia	
Executing agency:	Ministry of Finance	
Financing plan:	Reimbursable technical-cooperation financing from the FSO	
	IDB: (FSO)	US$2.0 million
	Local:	US$2.2 million
	Total:	US$4.2 million
Terms and conditions:	Amortization period:	40 years
	Grace period:	10 years
	Disbursement period:	30 years
	Interest rate:	1% first 10 years, 2% thereafter
	Supervision and inspection:	1%
	Credit fee:	0.5%
	Currency:	from the net income of the FSO

Objectives:

The proposed technical-cooperation project will support a fiscal sustainability support program (BO-0213) designed primarily to reduce the fiscal deficit by increasing fiscal revenue, and containing and reducing public spending on pensions. To achieve this main goal, two specific objectives have been targeted: (i) enhance the revenue collection capacity of the tax administration, and (ii) provide institutional strengthening for the government agency that administers the pay-as-you-go public pension system. More specifically, the proposed technical-cooperation project will include a series of activities to provide technical support to the two institutions responsible for administering tax collections and the public pension system: the Internal Revenue Service and the National Pension Payments Office. In terms of tax administration, improved efficiency in collections will help reduce the fiscal deficit by at least an estimated 0.3%. This goal cannot be achieved unless the management capacity of the Internal Revenue Service to audit taxpayers and fight tax fraud is significantly improved.

As for public pension system administration, the fiscal impact of the measures proposed in the program is expected to be at least a 0.1% decrease in the fiscal deficit thanks to increased efficiency in the fight against fraud and at least another 0.1% due to deindexation of pension payments to the dollar. Increasing efficiency in the fight against fraud assumes a significant transformation in the institutional and managerial model in the entire pensions administration system.

Description: The project will consist of two subprograms: (i) tax administration; and (ii) institutional strengthening of the pensions administration.

Subprogram I, tax administration, is designed to help improve efficiency in collections by the Internal Revenue Service, through three priority areas of activity: (i) information systems; (ii) staff training; and (iii) institutional consolidation. The basic strategy for information systems is to expand the information infrastructure and enhance the information available in terms of quality, quantity, and timeliness by integrating databases in a centralized computer model. Staff training will have a twofold objective: first, to strengthen audit capacity, particularly in the hydrocarbons sector, which due its complexity has had few resources allocated to it even though it has great collection potential; and second, to improve awareness of tax legislation and procedures, given the recent recruitment of a large percentage of the staff. Lastly, institutional consolidation is of particular import in a social context that has historically linked tax administration with corrupt practices. The idea now is to ensure that tax administration is perceived as honest and fully transparent.

Subprogram II, institutional strengthening of the pensions administration, revolves around three main axes: (i) professionalization of pension management staff through a career development regimes based on merit, capacity, and performance; (ii) staff training through reengineering of the main critical processes (recognition of contributions and certification of rights, insurance, review of current payments, management control systems, and so forth); (iii) identifying information system needs of the National Pension Payments Office; and (iv) computerization of current payment records and business payroll contributions.

Bank's country and sector strategy: The Bank strategy for Bolivia consists of three lines of activity: (i) economic growth and job creation, (ii) development of human capital and access to basic social services, and (iii) governance and consolidation of reform. The proposed operation is consistent with the third policy line insofar as strengthening the institutional framework of the tax and pensions administrations is part of the process of improving governance in the country. The Bank strategy supports all the components of the Bolivia's poverty reduction strategy (BPRS).[1] This operation will focus on those areas having to do with fiscal and financial sustainability in order to capitalize on the benefits of the HIPC initiative and to restore the country to a path of sustainable growth, an essential aspect of the first component of the BPRS of expanding opportunities for employment and income. This approach goes hand in hand with the need for steps to make the State a linchpin in the country's economic and social development, an area in which the Bank has been providing support through different initiatives to enhance transparency and efficiency in the public sector. Through the sector loan, the Bank will thus: (i) deepen and consolidate previous initiatives in the areas of tax administration and policy resulting in higher collections of internal revenue that can be applied to poverty reduction, (ii) restore Bolivia's finances more quickly to a sustainable fiscal position, and (iii) make more resources available to the authorities, giving them more leeway to act in the wake of the sharp drawdown in reserves brought about by the contraction of bank deposits in 2002.

Environmental/ social review: The sector project was considered and approved by CESI at its meeting on 28 March 2003. Given the nature of the program, it will have no direct environmental impact, since its components exclusively concern the efficiency of tax collection and modernization of the national pension system.

Benefits: The proposed technical-cooperation project will support fiscal sustainability in Bolivia by improving the efficiency and effectiveness of the Internal Revenue Service, the agency responsible for tax collection. The project will also directly address concerns about a high level of fraud in the public pay-as-you-go (PAYG) pension system, the lack of credibility of the Pensions Administration, the agency responsible for administration of payments under the public PAYG pension system, and the unreliable data bases that have a direct impact on recognition of pension benefits. The project will address these problems and introduce appropriate tools for attaining the goals set out in the fiscal sustainability program (BO-0213).

[1] The Bolivian poverty reduction strategy establishes four strategic components on the basis of which State action must be coordinated: (i) expand opportunities for employment and income; (ii) develop the productive capacity of the poor; (iii) increase security and protection for the poor; and (iv) promote integration and participation. In addition, the strategy covers cross-cutting lines of action such as institutional development, gender issues, and environmental protection.

Risks: The main risk for the program is associated with economic policy reforms. The viability of the pension system reform depends on whether those who stand to lose are clearly identified and can mobilize sufficient political capital to defend their interests as well as on whether winners will emerge from parallel reforms put in place. In the past, three main reasons accounted for the relatively rapid pace of pension reform in Bolivia: the president enjoyed a comfortable parliamentary majority; the impact was offset by the soaring number of first-time savers in the individually funded system and of Bonosol beneficiaries; and many specific effects of the reforms were intangible, during a transition period that had been generously accommodating more than just a few of the groups that might feel threatened. The current situation is very different because the president has insufficient parliamentary support and there is little likelihood of being able to identify parallel beneficiaries to make up for the reorganization of the pension system. Given this backdrop, a legislative package to reform the parameters of the pension system that would result in drastic spending cuts is not considered politically viable. The proposed project is focusing on small-scale policy reforms, especially efforts at administrative streamlining and fraud prevention, which by not clearly identifying the losers and being gradually phased in over time are likely to weaken potential resistance from those affected. However, given the eventual broadening of corruption control to other areas of society and the role discharged by intermediaries, organized resistance to the proposed measures cannot be ruled out. The introduction of new outreach and pensioner service policies is considered essential for minimizing these risks. Moreover, strengthening the tax and pensions administrations involves risks stemming from politicization of the central government in Bolivia and the lack of professionalization of its managerial staff. This problem is less serious in the case of the tax administration, which is being modernized under an institutional reform supported by the World Bank and the IDB. Once this program is completed, system sustainability will be the risk here. To address it, the proposed program includes conditions to consolidate the institutional structure.

On the pensions front, the risk is greater insofar as the Pensions Administration suffers from institutional weakness and its human resources policies have traditionally been based on cronyism and nepotism. This risk is not inconsistent with the agency's position as an important link in the economic policy reform described above. In this case, the program is geared to establishing a new institutional and organizational system that legitimizes the institutional

	framework through the creation of a national professionally staffed, transparent pension system with results-based management. In such a scenario, the availability of sufficient technical-cooperation funding to sustain this mechanism is considered a critical variable in neutralizing this risk.
Special contractual conditions:	As a condition precedent to the first disbursement of the funding, the government must establish the executing unit, to be attached to the Pension Payments Administration.
Social sector classification and poverty targeting:	Not applicable
Exceptions to Bank policy:	None
Procurement:	The selection and hiring of consulting services and all other procurement under the project will be conducted in accordance with the Bank's standard procurement procedures. International competitive bidding or prequalification will be required for the procurement of goods in amounts equal to or greater than US$350,000 equivalent or contracts for consulting services in amounts above US$200,000. After year one of the project, the Bank, may, on the basis of the executing agency's experience, perform ex post reviews by sampling of contracts for less than US$50,000 in the case of individual consultants and less than US$100,000 in the case of consulting firms.

I. INTRODUCTION

1.1 The fiscal sustainability program in Bolivia (BO-0213) will include a technical-cooperation loan to support its objectives and goals. The project will revolve around two components: (i) tax administration (component A), to be carried out by the Internal Revenue Service (SNII); and (ii) institutional strengthening of the pensions administration (component B), to be carried out by the Office of the Deputy Minister of Budget and Accounting, through the Pension Payments Administration.

1.2 Through its two components, the proposed technical-cooperation project will help: (a) increase the collection capacity of the tax administration (SNII) by improving its tools for data processing (standardized pension recipient data bases and equipment for centralized data processing), training in audit techniques, and institutional strengthening of the SNII; and (b) curb and reduce spending on public PAYG pensions by creating and institutionalizing an agency responsible for their administration (the National Pension Payments Office), which will assume **exclusive** responsibility for management of the current Pensions Administration.

II. DESCRIPTION OF THE TECHNICAL-COOPERATION PROJECT

A. Background

2.1 By law, **tax administration** is the responsibility of the Internal Revenue Service (SNII). Established in December 2000 as an autonomous agency under public law with administrative, functional, technical, and financial autonomy, the SNII operates under the supervision of the Ministry of Finance. Its purpose is to ensure efficient, effective administration of the tax system. The new organization and current legal framework of the SNII were designed to address basic problems in tax administration in Bolivia: (i) ongoing political interference; (ii) inadequate budgetary resources; and (iii) improper human resource management due to the low salaries, high turnover, and recruitment not based on merit and capacity.

2.2 Accordingly, the new law instituted a number of basic changes: (i) the SNII became a government agency with administrative, functional, and technical independence; (ii) the Executive President of the SNII is now appointed by the President of the Republic, based on a short list approved by a two-thirds majority of the Chamber of Deputies, for a fixed term of five years; (iii) the SNII has a Board of Directors, whose members are appointed following the same procedure as for the Executive President, and which consists of the Executive President and five members; (iv) the SNII now has a special financial system under which in principle it is allocated up to two percent of cash collections of internal taxes; and (v) the system for recruitment of SNII technical and administrative staff has been completely overhauled and will require public testing based on capacity, pursuant to the Institutional Reform Agreement (ARI).

2.3 The reform also provided that in the framework of its autonomy, the SNII must establish "annual commitments" with the Ministry of Finance that include at least: (i) the overall annual collections goal and the goal by District Office and for large taxpayers, indicating the assumptions on which the goals were based; (ii) the institutional plans to improve service quality and increase collections; (iii) the percentage of collections earmarked for the SNII budget; (iv) a summary of the relevant aspects of the annual SNII budget included in the National Budget; (v) the responsibilities of the SNII for implementation of the plans and participation by the Ministry of Finance and other government agencies in it; and (vi) any extenuating circumstances due to which the goals and agreements established by the parties were not fulfilled.

2.4 However, institutional overhaul of the SNII, which was launched in late 2001, has led to a difficult situation due to the specific circumstances of the organization, the economic and political situation, and the problems inherent in any structural change. Nevertheless, significant progress has been made in the process of change and institutional development and in terms of improving efficiency in collections (a 7.6% increase in a very weak economic environment), although the progress has been slower than expected.

2.5 During the SNII institutional reform process, the Bank carried out various supporting activities. Noteworthy among them was the ongoing SNII institutional strengthening program (PROFISI, loan 1043/SF-BO). This program consists of three components: organizational development, auditing, and information technology. It is currently at the final stages of implementation.

2.6 The progress achieved to date notwithstanding, as a second phase, there are still a number of problems that would be addressed under this component of the proposed technical-cooperation project. The following needs have been identified: (i) further enhance the information systems, moving from a distributed system to a centralized model that includes an enforced collection module; (ii) expand SNII staff training in auditing, especially in view of the fact that a large portion of the staff are recent hires; and (iii) ensure institutional consolidation of the SNII as a top priority strategic factor so that the new tax administration projects a responsible, honest image.

2.7 With regard to **administration of the public pension system**, in 1996 the Pension Act was passed, terminating the PAYG system and establishing administration of pension fund assets by private professional administration, pension fund managers (AFP). The Pension Act established two funds, the Individual Capitalization Fund (FCI) and the Collective Capitalization Fund (FCC). The FCI is a pay-as-you-go pension fund made up of individual accounts financed by employee contributions. Both funds became operational in 1997.

2.8 Those individuals who met the requirements as to age and number of contributions before the May 1997 cutoff date and were therefore entitled to pension recognition became part of a transitional system. Eventually to be eliminated, the transitional system is regulated and administered by the central government (currently the Pensions Administration). Pensions were to be financed by the Treasury, which would have resources obtained from the assets of the former basic and complementary systems. However, the transition is proving very costly: Treasury flows are almost double the expected payments, totaling 5% of GDP in 2002.

2.9 Fraud is more easily perpetrated in an environment in which there is serious institutional weakness. Six years after the reform, the institutional framework for administration of the public pension system is extremely weak, with very little internal and external oversight, minimum use of technology and procedures for transparent administration, and a lack of professional capacity among the staff, who turn over with every new administration. This institutional weakness is primarily due to the fact that when the reform was designed, sufficient attention was not paid to the institutions that would govern the public pension system, since it was assumed that it would eventually be phased out. The general configuration of the system and the rules for its administration did not undergo any structural changes and its management has not had a stable legal framework.

2.10 However, far from being phased out in the short term, according to the actuarial estimates available, the PAYG pension system is expected to continue for at least another 50 years. The reason is twofold: first of all, the current pensioners and beneficiaries have a relatively long life expectancy; and second, by law the public system administrating agency must recognize and certify the right to compensation of those individuals who switched to the private system under the Pension Act but who had made payments into the public system during a given period. The role of the agency in the fight against fraud demands a strong institutional structure in the area of management and technical and special professional capacities. The proposed sector program will support reform and strengthening in this area.

B. The technical-cooperation project

1. Objectives

2.11 The project has a twofold objective: (i) improve the collection capacity of the tax administration; and (ii) establish and provide institutional strengthening for an agency to administer the public PAYG pension system which would assume the administrative functions now performed by the Pensions Administration. Specifically, the project will include various subprojects to provide technical support to the two institutions responsible for administering tax collections and the public pension system: the Internal Revenue Service and the National Pension Payments Office.

2.12 With regard to **tax administration**, the increase in collections efficiency is expected to help reduce the fiscal deficit by at least 0.3%. This goal cannot be achieved without a significant improvement in the management capacity of the Internal Revenue Service in the areas of taxpayer auditing and the fight against tax fraud.

2.13 As for **public pension system administration**, the fiscal impact of the measures proposed in the program is expected to be at least a 0.1% decrease in the fiscal deficit thanks to increased efficiency in the fight against fraud and at least another 0.1% due to deindexation of pension payments to the dollar. Achieving increased efficiency in the fight against fraud assumes a significant transformation in the institutional and managerial model in the entire pensions administration system.

2. Description of the subprograms

2.14 The project will be carried out through technical-cooperation funding for two subprograms: (a) tax administration; and (b) institutional strengthening of pensions administration.

a. Subprogram I: tax administration (US$2.9 million)

2.15 The technical-cooperation funding will be used to hire consulting services and procure equipment and software for the following lines of activity: (i) technical assistance to support migration of the current distributed information system to a new centralized system and for development of new applications for audit management; (ii) procurement of new computer equipment necessary to implement the strategy of switching from a distributed data processing system to a centralized system, including strengthening of the communications networks and the necessary training; (iii) staff training in auditing; and (iv) consolidation of the institutional image of the SNII through anti-corruption measures.

2.16 The *first input* of this subprogram is **technical assistance** for information systems (US$800,000). Studies and reports on such systems show that applications for auditing and enforcement need to be improved first and that managers need complete, well structured management information. This input will assume continuity and deepening of the activities carried out under the SNII institutional strengthening program (PROFISI, under loan 1043/SF-BO).

2.17 The expected output of the subprogram is to: (i) strengthen the fight against tax fraud by supporting improved information in the taxpayer master file, reducing omissions, increasing the number and quality of audit activities and strengthening enforcement; (ii) strengthen audit capacity, especially in the hydrocarbons sector, to which few human and material resources have been allocated but which has a high collection potential; (iii) improve public information and citizen outreach services, reducing the level of tax evasion; and (iv) improve SNII management through information systems designed to facilitate decision-making.

2.18 The *second input* of the subprogram is strengthening of the **information infrastructure** in the Internal Revenue Service (US$1.87 million). Various reports indicate that the SNII information system is on the verge of saturation, with a high degree of fragmentation of basic information on taxpayers. It is therefore essential to migrate the current distributed system to a centralized computer system with all the attendant advantages in terms of operations, data consistency, and cost. The centralized strategy can be adopted thanks to the new communications infrastructure installed in the country in the past two years, which allows wide-band connection between the main cities and the La Paz node, addressing the data transmission problems that existed when the SNII was established. The project assumes additional support for the design implemented under the SNII institutional strengthening program (PROFISI, loan 1043/SF-BO).

2.19 The expected output of this input is an increase in the amount of consistent, complete, and timely information available in a single data base, in a high-yield environment that consolidates all SNII information services with centralized administration, security and lower costs. In addition, the centralized system is expected to allow various taxpayer information and assistance services, and tax return filing to go online.

2.20 The *third input* is **training** for the SNII staff in tax regulations and procedures (US$200,000). In the next few months, over 500 new staff members are expected to be hired. A special training effort is considered necessary, mainly for the audit staff and to prepare basic training materials. The following activities will be carried out: (i) seminars on audit methods and procedures; (ii) sector seminars on different specializations; and (iii) workshops to exchange international experiences.

2.21 The *fourth input* for this component is **institutional strengthening** of the SNII (US$30,000). This will involve technical assistance for public relations, change management, the fight against corruption, ethics and transparency, and internal oversight, through seminars for SNII staff.

2.22 The table below lists the main activities to be carried out to ensure fulfillment of the goals in the sector program matrix and their relationship with the sector program components.

Sector loan tranche	Main activities
Tranche II Program component 1	<u>Technical assistance in information systems</u> ▪ Centralize data and processes in consolidated environment ▪ Implement centralized administration of information services and supporting infrastructure ▪ Implement services to improve productivity and internal communications ▪ Implement security systems ▪ Implement server-based computing ▪ Implement PDF417 barcodes ▪ Adjust data models for mass use in high-yield environment ▪ Adjust system architecture and telecommunications to operate in centralized environment <u>Information technology infrastructure</u> ▪ Update new group of services for central level with clustering, high availability, and scalability (phase 2) ▪ Implement enterprise-class data backup solution ▪ Implement backup database server and off-site physical and telecommunications infrastructure ▪ Install light work stations ▪ Provide specialized training <u>Training</u> ▪ Seminars on audit methods and procedures ▪ Specialized sector seminars ▪ Workshops for exchange of international experiences <u>Institutional strengthening</u> ▪ Workshops on public relations, change management, the fight against corruption, ethics and transparency, and internal oversight
Tranche III Program component 1	<u>Technical assistance for information systems</u> ▪ Taxpayer status monitoring for management information ▪ Totaling by year of taxpayer sworn statements and payment vouchers ▪ Statistics on amount of time payment orders take at each stage of the process ▪ Criteria for taxpayer selection for auditing ▪ Office automation to monitor generation and reception of workload for legal action ▪ Implementation of web-based services <u>Information technology infrastructure</u> ▪ Internet service with clustering, high availability, and scalability ▪ Specialized training <u>Institutional strengthening</u> ▪ Workshops on public relations, change management, the fight against corruption, ethics and transparency, and internal oversight

b. Subprogram II: institutional strengthening of pensions administration (US$1.1 million)

2.23 In the area of pensions administration, the sector program will profoundly change the current institutional structure with a view to establishing a clear division of duties and responsibilities and improving institutional capacity for policymaking, planning, oversight, and management. Concretely speaking, the program will support a clear separation between: (i) planning, organization, and policymaking functions, which will be carried out by a new Pension Payments Administration[2] located in the Office of the Deputy Minister for the Budget and Accounting, given the goal of reducing spending; and (ii) management functions, which will be concentrated in a new National Pension Payments Office[3] (SENASIR), that will take over part of the activities the current Pensions Administration performs, but with modern systems for administration and management and staffed through a professional merit-based system. A principal/agent-type contractual arrangement will be established between the two agencies, setting the policy, objectives, goals and incentives for institutional strengthening, expense reduction, and the fight against fraud, along with the systems for monitoring and oversight of the results achieved.

2.24 In this context, the technical-cooperation funding will be used to procure consulting services to support institutional and operational strengthening of the new National Pension Payments Office.[4] The technical assistance will revolve around the following lines of activity: (i) professionalization of the National Pension Payments Office staff; (ii) training for SENASIR staff involved in the reengineering of critical processes; (iii) identification of SENASIR information technology needs as a result of process reengineering; and (iv) computerization of the data bases for current pension payments and business payroll contributions to the basic and complementary funds.

2.25 The *first input* is **professionalization of human resources** in the National Pension Payments Office (US$180,000). One of the main problems identified in the current Pensions Administration is the high turnover: of a staff of 236, 48% have been replaced with political appointees by the current administration without any review of their qualifications or skills. Moreover, 125 were hired as consultants, 45% of whom have also been replaced. This has led to a loss of capacity and of the necessary credibility for management of a very sensitive area, making it more difficult to ensure the specialization of functions through training programs.

2.26 The following consulting services will be provided for this input: (i) assess and redesign the organizational structure; (ii) adjust professional profiles and skills; (iii) size the staff; (iv) evaluate, select, and hire staff based on impartiality, merit, and professional capacity; (v) prepare the management model according to, the Civil Service Act (Law 2027); (vi) design the plan for professionalization of the

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2 The final name of the office will remain pending until the respective supreme decree is enacted.

3 The name of this office will not be final until the respective supreme decree is enacted.

4 It is important to note that concurrently with implementation of loan BO-0213, to supplement that project, another project for pensions administration will be launched under another nonreimbursable technical-cooperation operation (TC-0109003), with the following inputs: (i) organizational and functional design of the National Pension Payments Office; (ii) reengineering of critical processes; and (iii) streamlining of the SENASIR payment circuit.

staff; and (vii) implement the plan and provide advisory services for its implementation.

2.27 The primary output expected is that the management model for all staff in the National Pension Payments Office will be administered according to transparent merit-based standards in the process of selection and evaluation of efficiency in performance, subject to a disciplinary system in accordance with the Civil Service Act (Law 2027).

2.28 The *second input* for this subprogram is **training for staff affected by the reengineering of critical processes** (US$50,000).[5] The studies available show serious problems in major administrative processes: (i) user services: initiating procedures, review of initial documentation, and information on the status of claims; (ii) recognition of contributions and calculation of benefits; (iii) certification of rights and benefits, both under the new pension system and as compensation for contributions made under the old system; (iv) oversight of current payments (especially insurance, power of attorney, and successors); (v) design of the plan for implementation of process reengineering; (vi) implementation of reengineering plan and advisory services for implementation; (vii) training; and (viii) any others that may be deemed necessary, subject to prior agreement with the Bank.

2.29 The reengineering will assume a radical change in SENASIR working procedures and methods, shifting the focus of its activities to efficient, high-quality user services. This implies a need for broad-based retraining for the staff, which was used to the old system that paid little attention to user services, meaning new training needs. The training activities are therefore of strategic importance for the desired results in the reengineering to be achieved.

2.30 The *third input* for the subprogram is **identifying information technology needs** in the National Pension Payments Office (US$20,000). The changes to be made in the critical processes are expected to require changes in the information systems.

2.31 The following consulting services are linked to the above input: (i) hardware and software assessment; (ii) proposal for software needs and costing; (iii) proposal for hardware needs and costing; and (iv) implementation plan.

2.32 The expected output is a frame of reference for information technology needs and their cost.

2.33 The *fourth input* is **computerization of records** of business payroll contributions and current payment data (US$850,000). This is crucial data for recognition of the right to payment for the 25,000 files currently being processed or review and oversight of already recognized rights. These files will also be necessary for any of

[5] The process reengineering will be carried out with nonreimbursable technical-cooperation funding under project TC-0109003.

the almost 300,000 payment compensation cases expected to be filed in the coming years. All the files are in hard copy, in facilities that completely fail to meet the technical, technological, and physical standards such a center requires. Clearly the system is insecure and lacks organization. There is no manual on how to prepare reports. In short, the current working method makes the end result unreliable and a source of potential fraud.

2.34 The following activities will be carried out: (i) computerize files and documentation on a large scale, inputting the data into the administrative systems whenever a document is computerized; (ii) record digital images in the magnetic media provided by the respective software; (iii) make any necessary changes in the proprietary software and in National Pension Payments Office applications to ensure efficient access to the images in the files and proper linage between those systems and the proprietary software used; (iv) make automatic periodic backup files of all the data contained in both the files themselves and in the related documents and data bases; (v) conduct the testing necessary to ensure that the system works to the complete satisfaction of the National Pension Payments Office; and (vi) prepare the user manuals necessary for use of the system and train at least two Pension Office staff members in system use and maintenance.

2.35 The expected output of these activities will be two data bases respectively containing the basic data on corporate contributions to the basic and complementary funds and the files on payments in process. In both cases the data bases will help ensure better planning in the oversight of current payments, those pending approval, and compensation for contributions.

2.36 The table below details the main activities that will be carried out to ensure that the sector program matrix goals are met and their relationship to the program components.

Sector program tranche	**Main activities to be carried out**
Tranche II Program components 3 and 4	▪ Proposal for SENASIR staff professionalization ▪ Plan for information technology needs ▪ Computerization of corporate contributions to the basic and complementary funds ▪ Computerization of payment claims under review
Tranche III Program components 3 and 4	▪ Implementation of SENASIR staff professionalization ▪ Training for staff affected by reengineering of critical processes

C. Cost and financing

2.37 The total project budget is US$4.2 million equivalent, broken down by subprogram as follows: (i) US$2.9 million equivalent for subprogram I, tax administration, representing 69% of the total project cost; (ii) US$1.1 million for subprogram II, institutional development of the pension office, representing 26% of the total cost; and (iii) US$200,000 for coordination activities, or 5% of the estimated total.

	IDB	Local	Total
A. Tax administration	700,000	2,200,000	2,900,000
B. Institutional development of pensions administration	1,100,000		1,100,000
Total for subprograms	**1,800,000**	**2,200,000**	**4,000,000**
Coordination activities	140,000		140,000
Auditing activities	30,000		30,000
Ex post evaluation activities	30,000		30,000
PROJECT TOTAL	**2,000,000**	**2,200,000**	**4,200,000**

2.38 **Bank financing**: to cover the costs of this technical-cooperation project, a reimbursable loan (BO-0225) is proposed in the amount of US$2 million equivalent from the Fund for Special Operations. The loan would be executed by the Ministry of Finance in a 24-month execution period, with a 30-month disbursement period.

2.39 **Local counterpart contribution**: the local counterpart contribution will be an estimated US$2.2 million equivalent. It will be financed by the Government of Bolivia through the national budget and/or resources from other sources of international development funding.

2.40 The estimated cost of the inputs for subprogram I, tax administration, totals US$2.9 million equivalent, broken down as shown in the table below:

I. Tax administration	**IDB**	**Local**	**Total**
Technical assistance for SNII	700,000	100,000	800,000
Technology infrastructure for SNII		1,870,000	1,870,000
SNII staff training		200,000	200,000
Institutional strengthening		30,000	30,000
Component I Total	**700,000**	**2,200,000**	**2,900,000**

2.41 The inputs for subprogram II, institutional development of the pensions administration, will total an estimate US$1.1 million equivalent, broken down as shown in the table below:

II. Institutional development of pension office	**IDB**	**Local**	**Total**
Professionalization of human resources	180,000		180,000
Training for critical processes	50,000		50,000
SENASIR information technology needs	20,000		20,000
Computerization of pensioner data base	850,000		850,000
Component II Total	**1,100,000**		**1,100,000**

2.42 Lastly, the activities for coordination and execution of the two subprograms will amount to US$200,000.

D. Bank strategy and experience

2.43 The Bank strategy for Bolivia consists of three lines of activity: (i) economic growth and job creation, (ii) development of human capital and access to basic social services, and (iii) governance and consolidation of reform. The proposed operation is consistent with the third policy line insofar as strengthening the institutional framework of the tax and pensions administrations is part of the process of improving governance in the country.

2.44 The Bank strategy supports all the components of the Bolivia's poverty reduction strategy (BPRS)[6] and this operation will focus on those areas having to do with fiscal and financial sustainability in order to capitalize on the benefits of the HIPC initiative and to restore the country to a path of sustainable growth, an essential aspect of the first component of the BPRS of expanding opportunities for employment and income. This approach goes hand in hand with the need for steps to make the State a linchpin in the country's economic and social development, an area in which the Bank has been providing support through different initiatives to enhance transparency and efficiency in the public sector.

2.45 Through the sector loan, the Bank will thus: (i) deepen and consolidate previous initiatives in the areas of tax administration and policy resulting in higher collections of internal revenue that can be applied to poverty reduction, (ii) restore Bolivia's finances more quickly to a sustainable fiscal position, and (iii) make more resources available to the authorities, giving them more leeway to act in the wake of the sharp drawdown in reserves brought about by the contraction of bank deposits in 2002.

III. PROGRAM EXECUTION

A. The borrower

3.1 The borrower will be the Republic of Bolivia, represented in the loan contract by the Ministry of Finance.

3.2 As a condition precedent to the first disbursement of the technical-cooperation funding, the Ministry of Finance must submit evidence to the satisfaction of the

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[6] The Bolivian poverty reduction strategy establishes four strategic components on the basis of which State action must be coordinated: (i) expand opportunities for employment and income; (ii) develop the productive capacity of the poor; (iii) increase security and protection for the poor; and (iv) promote integration and participation. In addition, the strategy covers cross-cutting lines of action such as institutional development, gender issues, and environmental protection.

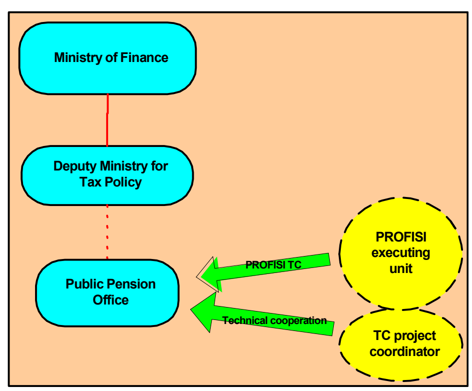
Bank that the executing unit reporting to the Pensions Administration responsible for execution of subprogram II has been established.

B. Program execution and administration

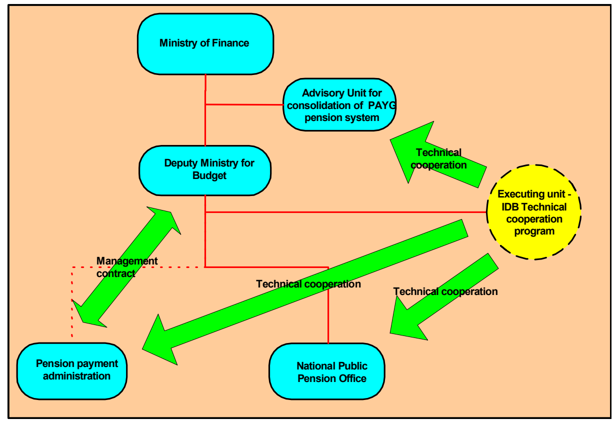
3.3 As the agency ultimately responsible for the fiscal sustainability program (BO-0213), the Ministry of Finance will be responsible for implementation of the two technical-cooperation subprograms. Supervision and coordination of each of the two subprograms will be linked through the respective two area coordinators. For subprogram I, tax administration, the coordinator will belong to the executing unit of the SNII institutional strengthening program (PROFISI, under IDB loan 1043/SF-BO). For subprogram II, institutional strengthening of the pension office, the coordinator will be responsible for an executing unit reporting to the Pensions Administration. The unit will have technical functions and will be staffed by a technical assistant and an administrative assistant.

3.4 The two coordinators will carry out the following duties: (a) prepare work plans and quarterly progress reports on each subprogram; (b) comply with the procedures for the procurement of goods and consulting services established by the Bank and authorize payments according to the procedures; (c) process requests for disbursement of the Bank funding and for local counterpart funding and ensure financial administration of the subprogram; (d) keep accounting records and supporting documentation and prepare financial statements for the subprogram; (e) coordinate execution of project activities and ensure that implementation proceeds smoothly; and (f) ensure that the project is carried out according to the contractual conditions agreed upon by the Bank and the Government of Bolivia.

3.5 The coordinator for subprogram I, **tax administration**, will carry out his or her duties in the executing unit of the SNII institutional strengthening program (PROFISI, under IDB loan 1043/SF-BO), which will provide support for the subprogram and for procurement of the necessary goods and services. The coordinator will be linked by contract to the executing unit, to which end the necessary funding has been allocated in the budget.



3.6 The coordination unit for subprogram II, **institutional development of pensions** administration, will report to the Office of the Deputy Minister for the Budget and Accounting, through the Pension Payments Administration. In addition to its own duties of supporting institutional strengthening of the SENASIR, the unit will provide full support to the Advisory Unit of the Ministry of Finance for consolidation of the pension system.



3.7 In addition to its responsibility for execution of subprogram II, the coordinator located in the Pension Payments Administration will also carry out the following duties: (i) consolidate information on execution of the two components of the technical-cooperation project, submitting the necessary reports to the Bank; and (ii) coordinate interagency relations, interacting with the Bank for all the activities and information connected with execution of the fiscal sustainability program (BO-0213).

C. Procurement of goods and services

3.8 The selection and hiring of consulting services and all other procurement under the project will be conducted in accordance with the Bank's standard procurement procedures. International competitive bidding or prequalification will be required for the procurement of goods in amounts equal to or greater than US$350,000 equivalent or contracts for consulting services in amounts above US$200,000.

3.9 After year one of the project, the Bank, may, on the basis of the executing agency's experience, perform ex post reviews by sampling of contracts for less than US$50,000 in the case of individual consultants and less than US$100,000 in the case of consulting firms.

D. Disbursements and revolving fund

3.10 A revolving fund of up to 5% of the Bank financing will be established for disbursement of the reimbursable technical-cooperation funding, through the establishment of a special bank account in the name of the project. Semiannual progress reports on the status of the revolving fund in the hands of the executing agency will be submitted within 60 days after the end of each six-month period, in June and December of each year. All the supporting documentation for the disbursement requires will be reviewed ex ante.

E. Execution period and disbursement timetable

3.11 For both the proposed reimbursable technical-cooperation funding (BO-0225) and the nonreimbursable technical-cooperation funding (TC-01-09-003), the project execution period will be a maximum of 24 months and the disbursement period, 30 months, calculated from the effective date of the contract to be entered into by the Government of Bolivia and the Bank.

F. Accounting and auditing

3.12 The executing agency must have a system for internal oversight and separate financial and accounting records in order to: (i) identify the financial transactions made using the proceeds of the reimbursable technical-cooperation funding by investment category and source of financing; and (ii) prepare period financial statements on the project.

3.13 An independent auditing firm acceptable to the Bank will conduct an annual audit of the reimbursable technical-cooperation loan throughout the project execution period, pursuant to Bank policies, according to terms of reference previously agreed upon with the Bank (AF-400). The firm will be selected according to Bank procedures (AF-200) and the reports must be submitted to the Bank within 120 days after the end of each calendar year. The costs of auditing will be part of the project costs and will be financed using the proceeds of the Bank financing.

G. Monitoring and evaluation

3.14 Project activities will be carried out in accordance with an annual program established in semiannual work plans (SWPs), to be agreed on with the Bank at semiannual monitoring meetings. The SWPs will contain at least the following information: (i) an evaluation of the activities carried out in the preceding period and the accomplishments; (ii) a description of the activities to be carried out in the next six-month period; (iii) the objectives and targets for each group of activities and the indicators that will be used to gauge the extent to which such objectives and targets have been met; (iv) the work schedule, together with the corresponding costs; and (v) the financing requirements for the period.

3.15 The SWPs will be submitted to the Bank in the first month of each six-month period to allow time for organizing the annual meetings to take place before the end of the next semiannual period. The executing agency and the Bank will meet every six months to monitor and assess the progress made in the preceding six-month period, and to determine the extent to which the criteria for disbursement and project technical execution have been fulfilled and to agree on the corresponding SWPs.

3.16 The government and the Bank have agreed that an ex post evaluation of the sector program will be conducted and will be financed with the proceeds of the proposed technical-cooperation loan.

H. Lessons learned

3.17 **Political support, legal assistance, and institutional leadership**. The results of the presidential and parliamentary elections held in June 2002 showed that the electorate was split across four different parliamentary camps, without any party holding a clear majority as well as the emergence of new political groups from outside the traditional party system. This new configuration of parliamentary forces prevented the formation of a majority in the parliament that was needed for the election of a new president, and later influenced the design of the government's program and how it was subsequently implemented. Following lengthy negotiations in August 2002, the new president was elected and a coalition government was formed by two parties with the partial support of other smaller parties.

3.18 In the final quarter of 2002 and the first quarter of 2003, the Bolivian government working in this climate of parliamentary instability prepared a macroeconomic program to restore growth and to control and reduce the deficit. At the same time, negotiations opened with the International Monetary Fund on a new agreement under the Poverty Reduction and Growth Facility. The government's new program arranged with the IMF was to include tax policy reforms such as the introduction of the income tax, a simplified tax regime, and amendments to the hydrocarbons legislation. Other measures included efforts to cut spending on personnel and to place a ceiling on soaring pension costs, all of which were brought into the sector program that the Bank was preparing together with the Bolivian government. In February 2003, these reforms were introduced in the Legislative Branch in the form of a new proposed budget for 2003. The reforms proposed in the bill, particularly those relating to tax policy and government wages and salaries were not only opposed by the opposition but they also sparked mass demonstrations and protests that led to riots and civil disorder.

3.19 In the face of such opposition, the government withdrew the budget reform bill and initiated a consultative process on a revised budget bill, and shuffled most of the government team. A new bill was introduced in the Legislature and is now being reviewed by the Finance Commission of the Chamber of Deputies. The tax policy measures originally planned have been left out of the new bill, which has less draconian spending controls, particularly in the areas of current and capital spending. This latest government proposal adheres to the new deficit targets agreed on with the IMF that are part of a new stand-by arrangement now under study by the IMF board of directors. The present operation is designed to augment revenue collection, reduce inefficiencies, and control pension spending. To this end, the measures and targets it contains will be consistent with the eventual agreement with the IMF.

3.20 The Legislature recently passed the Executive Branch Restructuring Act (LOPE), which seeks a profound restructuring of structure of the government. The act's enabling regulations (Supreme Decree 26973) do not contain any significant changes affecting taxation and the Office of the Deputy Minister of Pensions, which until that time had been part of the Office of the Deputy Minister of Financial Affairs, was eliminated and integrated into the new structure with the rank of division within the Ministry of Finance. Under the Executive Branch's commitments with the Bank, all authority for pension payments will rest with the Office of the Deputy Minister of Budget and Accounting, with the creation of the Pension Payments Administration, whose functions are oversight, regulation, and control of the system. The administrative functions will be transferred to a new national service that is deconcentrated. A management contract will be signed between both institutions. In leading this process of institutional strengthening and technical cooperation, the Coordinating Unit will be located within the Pension Payments Administration in order to have the necessary political support and ensure that the framework is institutionally consistent.

3.21 **Communications and dissemination.** As part of the project, actions will be undertaken to disseminate within and outside the government the objectives, activities, and targets of the fiscal sustainability support program (BO-0213). It is particularly important to enhance the Internal Revenue Service's public image as a government entity that operates on principles of professionalism, probity, and transparency. As to an institutional framework for pensions, a communications plan must be designed to disseminate the progress made in the institutionalization process, in terms of efficiency and effectiveness, superior service to the public, and the probity of its employees.

3.22 **Small gains.** The process of reform is a complex one involving many different participants. Any successes emanating from the process must be perceptible and must be obtained quickly and used to demonstrate that the reforms under way are working. These "small gains" will make it possible to win support among the public and those social groups directly affected.

IV. VIABILITY AND RISKS

A. Technical and institutional viability

4.1 The technical-cooperation project was conceived to conform closely to the mission and functions of the Ministry of Finance and the Internal Revenue Service. Specifically, all project activities are consistent with the tasks corresponding to the Internal Revenue Service and the Pension Payments Administration. Also, the scope of this project was designed with the active involvement of and in consultation with the officials monitoring the different components in each agency. It was previously ascertained that they have the capacity to follow up and provide guidance on execution of the operation. Accordingly, there is enough commitment to the operation to ensure that it will be accepted and successfully completed.

4.2 It is important to note that the Internal Revenue Service has been the beneficiary of other Bank technical assistance projects. Hence, the agency has officials already familiar with implementing and administering operations of this kind, a factor that will facilitate the operation. To establish a National Pension Payments Office with a proper institutional framework, advisory assistance will be provided by an expert to support the Pension Payments Administration.

B. Environmental and social viability

4.3 The sector project was considered and approved by CESI on 28 March 2003. Given the nature of the program, it will have no direct environmental effects it includes policy measures concerned solely with improving the efficiency of tax revenue collection and modernizing the national pension system.

C. Benefits

4.4 The proposed technical-cooperation project will support fiscal sustainability in Bolivia by improving the efficiency and effectiveness of the Internal Revenue Service, the agency responsible for tax collection. The project will also directly address concerns about a high level of fraud and the lack of credibility of the Pensions Administration, the agency responsible for administering payments under the public pension system, and the unreliable data bases that have a direct impact on recognition of pension benefits. The project will address these problems and introduce appropriate tools for attaining the goals set out in the fiscal sustainability program (BO-0213).

D. Risks

4.5 The main risk for the program is associated with economic policy reforms. The viability of the pension system reform depends on whether those who stand to lose are clearly identified and can mobilize sufficient political capital to defend their interests as well as on whether winners will emerge from parallel reforms put in place. In the past, three main reasons accounted for the relatively rapid pace of pension reform in Bolivia: the president enjoyed a comfortable parliamentary majority; the impact was offset by the soaring number of first-time savers in the individually funded system and of *Bonosol* beneficiaries; and many specific effects of the reforms were intangible, during a transition period that had been generously accommodating to more than just a few of the groups that might feel threatened.

4.6 The current situation is very different because the president has insufficient parliamentary support and there is little likelihood of being able to identify parallel beneficiaries to make up for the reorganization of the pension system. Given this backdrop, a legislative package to reform the parameters of that system that would result in drastic spending cuts is not considered politically viable. The proposed project is focusing on small-scale policy reforms, especially efforts at administrative streamlining and fraud prevention, which by not clearly identifying the losers and being gradually phased in over time, are likely to weaken potential resistance from those affected. However, given the eventual broadening of corruption control to other areas of society and the role discharged by intermediaries, organized resistance to the proposed measures cannot be ruled out. The introduction of new outreach and pensioner service policies is considered essential for minimizing these risks.

4.7 Moreover, strengthening the tax and pensions administrations involves risks stemming from politicization of the central government in Bolivia and the lack of professionalization of its managerial staff. This problem is less serious in the case of the tax administration, which is being modernized under an institutional reform supported by the World Bank and the IDB. Once this program is completed, system sustainability will be the risk here. To address it, the proposed program includes conditions to consolidate the institutional structure.

4.8 On the pensions front, the risk is greater insofar as the Pension Office suffers from institutional weakness and its human resources policies have traditionally been based on cronyism and nepotism. This risk is not inconsistent with the agency's position as an important link in the economic policy reform described above. In this case, the program is geared to establishing a new institutional and organizational system that legitimizes the institutional framework through the creation of a national professionally staffed, transparent pension system with results-based management. In such a scenario, the availability of sufficient technical-cooperation funding to sustain this mechanism is considered a critical variable in neutralizing this risk.

NONREIMBURSABLE TECHNICAL-COOPERATION FUNDING FOR A SECTOR PROGRAM TO SUPPORT FISCAL SUSTAINABILITY

(TC-01-09-00-3)

EXECUTIVE SUMMARY

Borrower:	Republic of Bolivia	
Executing agency:	Ministry of Finance	
Financing modality:	Reimbursable technical-cooperation funding from the FSO	
	IDB (FSO):	US$500,000 (equivalent)
	Total:	US$550,000 (equivalent)
Terms and conditions:	Disbursement period:	30 months
	Inspection and supervision:	N/A
	Credit fee:	N/A
	Currency:	United States dollar

Objectives: The technical-cooperation project complements a fiscal sustainability support program (BO-0213) intended primarily to achieve deficit reduction through higher fiscal revenues, retrenchment, and reductions in public pension costs. Two specific goals have been proposed to attain this objective: (i) to enhance the revenue collection capacity of the tax administration, and (ii) to provide institutional strengthening for the government entity that administers the pay-as-you-go public pension system. More specifically, two technical-cooperation projects will be implemented under the program. These projects will include different activities that lend technical support to the Servicio de Impuestos Internos [Internal Revenue Service] and the Servicio Nacional del Sistema de Reparto [National Pension Payments Office], the two institutions in charge of administering respectively, tax collection and the public pension system. The focus of the present project (TC-01-09-00-3) will concentrate exclusively on pension reform.

Description: The present project targets the pensions system and its thrust is threefold: (i) institutional and organizational strengthening of the pension system, with a clear separation between the functions of policy formulation, regulation, control, and supervision and the functions of operating management, all within a process of institution building and upgrading of pension staff; (ii) the reengineering of the main critical processes (recognition of contributions and certification of rights, insurance, current pension payments review, management control systems, etc.); and (iii) a national bank-based payment circuit system.

The Bank's strategy for the country and the sector:

The Bank's strategy for the country rests on three pillars: (i) economic growth and job creation, (ii) development of human capital and access to basic social services, and (iii) governance and consolidation of reform. The present operation fits in with the third pillar of this strategy insofar as strengthening the institutional framework of the tax and pensions administrations is part of the process of improving governance in the country. The Bank's strategy supports all components of Bolivia's poverty reduction strategy (BPRS)[1] and this operation will concentrate on those aspects having to do with fiscal and financial sustainability in order to capitalize on the benefits of the HIPC initiative and to restore the country to a path of sustainable growth, an essential aspect of the first component of the BPRS, as are the other elements of job creation and income growth. This goes hand in hand with the need for steps to make the State the linchpin of the country's economic and social development, an area in which the Bank has been providing support through different initiatives to enhance transparency and efficiency in the public sector. Through the present sector loan, the Bank will (i) deepen and consolidate previous initiatives in the areas of tax administration and policy, resulting in a greater reallocation of internal resources to poverty reduction, (ii) restore Bolivia's finances more quickly to a sustainable fiscal position, and (iii) make more resources available to the authorities, giving them more leeway to act in the wake of the sharp drawn down in reserves brought about by the contraction of bank deposits in 2002.

Environmental and social review:

The sector project was considered and approved by CESI on 28 March 2003. Given the nature of the program, it will have no direct environmental effects since it includes policy measures concerned solely with improving the efficiency of tax collection and modernizing the national pension payments system.

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[1] The Bolivian Poverty Reduction Strategy consists of four strategic pillars, on which the State's activities must be coordinated: (i) to expand employment opportunities and raise income; (ii) to endow the poor with the skills to become more productive; (iii) to improve security and protection for the poor; and (iv) to promote integration and participation. The strategy also targets such cross-cutting areas as institutional strengthening, gender, and the environment.

Benefits: The technical-cooperation project seeks to alleviate concerns about the high level of pension fraud and the poor credibility of the Pensions Administration, the agency in charge of the pay-as-you-go (PAYG) public pension system, and about unreliable administrative records, which directly affect recognition of pension benefits. The project will address these problems and introduce tools for attaining the goals set out in the fiscal sustainability support program (BO-0213).

Risks: The main risk associated with the program has to do with economic policy reforms. The viability of the pension payments system reform depends on whether those who stand to lose are clearly identified and can mobilize sufficient political capital to defend their interests as well as on whether winners will emerge from parallel reforms put in place. In the past, three main factors accounted for the relatively rapid pace of pension reform in Bolivia: the president enjoyed a comfortable parliamentary majority; the effects were offset by the soaring number of first-time savers in the individually funded system and of *Bonosol* beneficiaries; and many specific effects of the reforms were intangible, during a transition period that had been generously accommodating to more than just a few of the groups that might feel threatened. The present situation is very different because the president lacks sufficient parliamentary support and there is little likelihood of being able to identify parallel beneficiaries to make up for the rationalization of the PAYG system. Given this backdrop, a legislative package to reform the parameters of that system that results in drastic spending cuts is not considered politically feasible. Consequently, the present project is betting on gradual policy reforms, with a focus on efforts at administrative rationalization and fraud prevention, which, by not clearly identifying those who are unlikely to benefit and being introduced slowly by degrees, is likely to weaken potential resistance from those affected. However, given the potentially pervasive presence of corruption in society and the role discharged by intermediaries, organized resistance to the proposed measures cannot be ruled out. The introduction of new communications and pensioner service policies is considered essential for minimizing these risks. Also, the strengthening of the pensions administration risks politicizing the country's public sector and creating a deficit of professionally trained personnel. To counter this risk, conditions will be established under the program to strengthen the institutional framework.

On the pensions front, the risk is greater insofar as the entity is institutionally weak and human resources policies have traditionally been based on cronyism and nepotism. This risk is not inconsistent with the entity's position as an important link in the economic policy

	reform described. In this case, the program is geared to establishing a new institutional and organizational system that legitimizes the institutional framework through the creation of a national professionally staffed pension payments office characterized by transparency and results-based management. In such a scenario, the availability of sufficient technical-cooperation funding to sustain this mechanism is considered a critical variable in neutralizing this risk.
Special contractual clauses:	As a condition precedent to the first disbursement of the technical-cooperation funding, the government will set up an Executing Unit within the Pension Payments Administration.
Social sector and poverty classification:	Not applicable
Exceptions to Bank policy:	None
Procurement:	All procurement of goods and services for the project will be conducted in accordance with the Bank's standard procurement procedures. International competitive bidding or prequalification will be used for contracts valued at the equivalent of US$350,000 or more in the case of goods and over US$200,000 in the case of services. After year one of the project, the Bank, may, on the basis of the executing agency's experience, perform ex post reviews of a sample of services contracts valued at less than US$50,000 in the case of individual consultants and less than US$100,000 in the case of consulting firms.

I. INTRODUCTION

1.1 The program to support fiscal sustainability (BO-0213) will consist of a technical-cooperation loan to help attain the objectives and goals of establishing an institutional framework for the pensions regime. This loan and the activities associated with it will be carried out by the Pension Payments Administration on behalf of the Office of the Deputy Minister of Budget and Accounting.

1.2 The technical-cooperation project will assist with the process of containing and reducing government pension expenses through the creation and establishment of an institutional framework for the entity that administers the pension system (National Pension Payments Office), which will assume **sole** responsibility for the present system.

II. DESCRIPTION OF THE PROJECT

A. Background

2.1 The *Pension Act* passed in 1996 terminated the existing pay-as-you-go pension system and placed the administration of pension fund assets in the hands of private professional administrators, the Pension Fund Manager (AFP). The Pension Act set up an Individual Capitalization Fund (FCI) and a Collective Capitalization Fund (FCC). The FCI is a fully funded pension plan consisting of individual pension accounts funded with individual employee contributions. The two funds began functioning in 1997.

2.2 All individuals who were entitled to receive a pension on the basis of age and contributions paid prior to the May 1997 deadline were transferred to a temporary regime, to eventually lapse, regulated and administered by the Public Pensions Administration (now the Pensions Administration). Pensions were to be funded by the Treasury, with the assets from the previously terminated basic and supplementary funds. However, this transition is turning out to be extremely costly. Payments by the Revenue Department have been nearly twice what was projected, amounting in 2002 to nearly 5% of GDP. A number of factors account for this high cost: there are more pensioners than originally estimated, the average pension is higher than anticipated, and the rules governing the indexation of pensions are extremely generous. In addition, many different regulations governing the pension payment system make it difficult to bring spending under control, thus effectively preventing cost cutting. Moreover, a setting of inadequate governance has produced conditions that encourage fraud and evasion. According to some estimates, fraud may amount to as much as one half a percent of GDP.

2.3 Fraud is easier to commit in an environment of serious institutional weakness. Six years after the reform, the institutional framework for administration of the pension system is still very fragile. There area few internal and external controls, minimal use is made of technology and administration procedures are not transparent, and the few professionals in the pension service are replaced with each change of government. This institutional weakness is due primarily to the fact that when the reform was drafted scant attention was given to the institutions that would regulate the pension system since it was assumed that the system would "disappear". Hence, its overall configuration and rules of administration were not structurally modified and no stable legal framework is in place for its administration.

2.4 Far from lapsing within a short time, however, the pay-as-you-go (PAYG) pension system will effectively endure, according to present actuarial estimates, for at least another 50 years partly because existing pensioners and beneficiaries have a relatively long life expectancy but also because the public pension system administrator is required by law to recognize and certify the benefits rights of all beneficiaries transferred under the Pension Act to the private pension system who had made contributions to the public pension system for any given period. The role that this agency must discharge in fraud prevention calls for a strong institutional framework administered by staff with the proper professional and technical skills. The sector program will assist with the reform and strengthening of this framework.

B. Technical-cooperation project

1. Objectives

2.5 The purpose of the technical-cooperation project is to create and provide institutional strengthening for an entity to administer the public (PAYG) system that will be responsible for the administrative functions performed by the present Pensions Administration.

2. Description of activities and outputs

2.6 The sector program proposes to introduce deep-seated reforms to the present institutional framework in order to define clearly the functions and responsibilities of Pensions Administration and to develop the institutional capacity in the areas of policy, planning, control, and administration. Specifically, the program will support a clear separation between (i) functions of planning, regulation, and supervision under a new Pension Payments Administration[2] to be attached to the Office of the Deputy Ministry of Budget and Accounting because the aim is to control spending; and (ii) management functions will be concentrated in a new National Pension Payments Office[3] (SENASIR), which will take over the functions now performed

[2] The designation will not become definitive until approved by supreme decree.
[3] This designation will not become definitive until approved by supreme decree.

by the present Pensions Administration but with modern systems of administration and management, and professionals who hold their positions on the basis of merit. A contractual arrangement of principal and agent will be established between both institutions, which will set out the policy objectives and goals of institutional strengthening and the incentives offered, spending control, and fraud prevention, and the mechanisms for control and monitoring of the results.

2.7 In this context, the technical-cooperation funding will be used to hire consultants to assist with the process of institutional and operational consolidation of the new National Pension Payments Office.[4] The technical assistance will hinge on the following thrusts: (i) organizational and functional design of the National Pension Payments Office; (ii) critical process reengineering; and (iii) rationalization of the pension payments circuit.

2.8 The *first output from* this component will be the **organizational and functional design of the National Pension Payments Office** (US$140,000). Various evaluation reports on the organizational structure of the present Pensions Administration show that the organizational model is a traditional functional one that is periodically updated and revised but without an analysis of the relevance of the activities themselves that are performed within the framework of a modern management model. In fact, some of the units analyzed have different functions and report to bodies other than those indicated in the Administration's Organizational Chart. Furthermore, the present structure does not provide for an evolutionary process that the Administration needs to follow, whereby the most recent pension payments lose priority to management of benefits payments and control of previously recognized pension payments. For this reason, some areas of differentiated tasks such as assistance to pensioners or other emerging areas such as fraud prevention do not appear correctly described. Based on the shortcomings detected, the new organizational design will need to consider the mechanisms for making the transition from the old structure of the present Pensions Administration to the new Pension Payments Office that will be consolidated within SENASIR.

2.9 The consulting activities envisaged under this component are as follows: (i) analysis of management and administrative functions; (ii) redesign of general administrative procedures; (iii) scaling of the organizational structure; (iv) preparation of organizational and functions manuals; (v) design of the

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4 It is important to point out that to supplement loan BO-0213 as it is being carried out another project financed under a technical cooperation loan will be implemented in the pensions area. The aims of this loan are (i) the professional development of the staff of the National Pension Payments Office; (ii) training for SENASIR staff involved in critical process reengineering; (iii) determination of SENASIR's information technology needs as a result of the reengineering process; and (iv) computerization of databases of records of current pensions and schedules of business contributions to basic and supplemental funds.

implementation plan; and (vi) implementation and advisory assistance for implementation.

2.10 These activities will help to strengthen the capacity of the National Pension Payments Office to administer the payments and benefits contribution system, and particularly its ability to prevent fraud and to improve the efficiency and quality of the services offered to pensioners.

2.11 Given the strategic nature of this product, an international consultant specializing in Pensions Administration systems and organizations will be hired to provide advisory assistance to the other consultants involved in this component while they carry out their activities. The main aim will be to ensure proper coordination between all parts of the SENASIR institutional strengthening and modernization process.

2.12 The *second output* that will flow from this component is **critical process reengineering** (US$235,000). Available studies show serious problems in the most important administrative processes: (i) user service: initiation of processes and information on file status; (ii) recognition of contributions and benefits calculation; (iii) certification of rights and benefits under the new pensions and from contributions compensation; (iv) pension control in progress (insurance, holders' rights and entitlements, in particular); (v) design for implementing the process reengineering; (vi) implementation of the reengineering and advisory support therefor; and (vii) training.

2.13 Attaining this output in each of the processes identified will require the following consulting activities: (i) assessment of the present system of procedures by means of an information survey of processing flows and times, document processing for the case file, analysis of the units involved and decision-making targets; (ii) the process reengineering design, with specific information on new flows (flow charts), expected times, documentation required for the case file, units involved, and specific information on responsibilities; (iii) establishment of an implementation plan, with details of its resource requirements; and (iv) training plan.

2.14 The outcome of this product will go a long way to improving the transparency, efficiency, and quality of administrative procedures, in the context of a management model conceived according to a management by results model.

2.15 The third output will address the **payment circuit rationalization** (US$120,000). This process is critical because of its importance in guaranteeing that the pensioner is effectively paid his pension and because it is the level at which periodically (once a month) the pensioner and the pension agency interact. This makes it possible to establish the identity of the beneficiary. As noted earlier, the present procedure is to deliver cheques by hand on specified days. The individuals performing this function are able to verify two facts: the recipient is who he says he is and the regularity with which payments are made since previous delivery receipts may be requested. The agent makes some payments in cash or through an agent when for health reasons the pensioner is unable to travel or move about. In such cases the agent delivers cash to the recipient's home and receipt is confirmed by means of a signature or thumb mark. There are also agents who cash the payments for various reasons. For payments made in the city of La Paz, the football stadium needs to be reserved. The idea is to change this system completely, and outsource payments to the banking system, with specific mechanisms for verifying identity.

2.16 The following consulting activities are proposed for the operation: (i) assessment of the present payment systems by means of an information survey of processing flows and times, processing of required documents, and an analysis of the units involved; (ii) analysis of payment options available within the banking system and at payment offices; (iii) process reengineering design, with specific information on new flows (flow charts), expected times, personal identity card for payments verification, units involved, specific information on responsibilities, and systems for exchanging information between the National Pension Payments Office and the payment circuit; (iv) implementation plan with details of the resources required; and (v) a training plan.

2.17 The reengineering of the payment system and the outsourcing of payments to the banking system is expected to provide pensioners with a convenient and efficient service with expanded controls to verify pensioner identity.

2.18 Set out in the table below are the main activities that will need to be carried out to ensure compliance with the targets of the sector program matrix and their relationship to the program components.

Sector program tranches	Principal activities
Tranche II Program components: 3 and 4	▪ Proposed design and organizational structure of National Pension Payments Office ▪ Proposed upgrading of SENASIR professional staff ▪ Plan for critical process reengineering ▪ Plan for new payment circuit
Tranche III Program components: 3 and 4	▪ Establishment of National Pension Payments Office organizational structure ▪ Implementation of critical process reengineering ▪ Introduction of new payment circuit

C. Cost and financing

2.19 The total project budget amounts to the equivalent of US$500,000 in nonreimbursable financing to be drawn on the FSO. A breakdown of the budget by product is given in the table below:

Product	IDB	Counterpart	TOTAL
Rationalization of SENASIR organizational structure	140,000	20,000	160,000
Critical process reengineering	235,000	15,000	250,000
Rationalization of payment circuit	120,000	15,000	135,000
Audits	5,000		5,000
	500,000	**50,000**	**550,000**

D. The Bank's strategy and experience

2.20 The Bank's strategy for the country rests on three pillars: (i) economic growth and job creation, (ii) development of human capital and access to basic social services, and (iii) governance and consolidation of reform. The present operation fits in with the third pillar of this strategy insofar as strengthening the institutional framework of the tax and pensions administration is part of the process of improving governance in the country.

2.21 The Bank's strategy supports all components of Bolivia's poverty reduction strategy (BPRS)[5] and this operation seeks to focus on those aspects having to do with fiscal and financial sustainability in order to capitalize on the benefits of the HIPC initiative and to restore the country to a path of sustainable growth, an essential aspect of the first component of the BPRS, as are the other elements of sustainable growth, job creation, and income growth. This goes hand in hand with the need for steps to make the State the linchpin of the country's economic and social development, an area in which the Bank has been providing support through different initiatives to enhance transparency and efficiency in the public sector.

2.22 Through the present sector loan, the Bank will (i) deepen and consolidate previous initiatives in the areas of tax administration and policy, resulting in a greater

5 The Bolivian Poverty Reduction Strategy consists of four strategic pillars, on which the State's activities must be coordinated: (i) to expand employment opportunities and raise income; (ii) to endow the poor with the skills to become more productive; (iii) to improve security and protection for the poor; and (iv) to promote integration and participation. The strategy also targets such cross-cutting areas as institutional strengthening, gender, and the environment.

mobilization of internal resources for poverty reduction, (ii) restore Bolivia's finances more quickly to a sustainable fiscal position, and (iii) make more resources available to the authorities, giving them more leeway to act in the wake of the sharp drawn down in reserves brought about by the contraction of bank deposits in 2002.

III. PROGRAM EXECUTION

A. Borrower

3.1 The borrower will be the Republic of Bolivia, to be represented in the contract by the Ministry of Finance.

3.2 As a condition precedent to the first disbursement of the technical-cooperation funding, the Minister of Finance will be required to demonstrate, to the Bank's satisfaction, that the executing unit has been set up within the Pension Payments Administration.

B. Organizational structure for project execution

3.3 Responsibility for execution of all components of the technical-cooperation project will fall to the Ministry of Finance, as the ultimate authority for the fiscal sustainability support program (BO-0213). The project coordinating unit for loan BO-0225 will be in charge of supervision and coordination.

C. Procurement

3.4 All procurement of goods and services for the project will be conducted in accordance with the Bank's standard procurement procedures. International competitive bidding or prequalification will be used for contracts valued at the equivalent of US$350,000 or more in the case of goods and over US$200,000 in the case of services.

3.5 After year one of the project, the Bank, may, on the basis of the executing agency's experience, perform ex post reviews of a sample of services contracts valued at less than US$50,000 in the case of individual consultants and less than US$100,000 in the case of consulting firms.

D. Disbursements and revolving fund

3.6 To facilitate disbursement of the technical-cooperation loan, a revolving fund of up to 5% of the Bank financing will be set up in a special bank account in the project name. Within 60 days after the end of each six-month period ending in June and December for the duration of the project, the executing agency must submit a report describing the status of the revolving fund under its administration. An ex ante review will be performed of all documentation used to justify disbursement requests.

E. Execution period and disbursement timetable

3.7 The execution period for the technical-cooperation loan (BO-0225) and for the nonreimbursable technical-cooperation funding (TC-01-09-00-3) will be a maximum of 24 months and the disbursement period a maximum of 30 months from the effective date of the contract signed between the Government of Bolivia and the Bank.

F. Accounting and audits

3.8 **Responsibility of the executing agency:** The executing agency will be responsible for: (i) keeping special separate accounts for the Bank's financing and the local counterpart contribution; (ii) preparing and submitting to the Bank disbursement requests, together with documentation justifying disbursements of the Bank's contribution and the local counterpart funding; (iii) keeping proper accounting and financial records and an internal audit system for the project resources, together with documentation to verify the transactions and facilitate timely preparation of documentation justifying eligible expenses and of financial statements and reports; (iv) keeping proper records of documentation evidencing project expenses; and (v) preparing and submitting to the Bank semiannual reports on the status of the revolving fund and a final statement of all expenses incurred in connection with the project out of the proceeds of the nonreimbursable technical-cooperation funding.

3.9 **External audits.** Within 90 days after the final disbursement of the project financing, the executing agency will prepare and submit to the Bank a final statement of expenses charged to the project that are to be funded out of the Bank's financing and the local counterpart funding. This statement must be audited by a firm of independent auditors acceptable to the Bank in accordance with terms of reference previously approved by the Bank (AF-400). The auditing firm must be selected in accordance with the Bank's procedures (AF-200) and the cost of the audit will be paid out of the Bank's financing.

G. Monitoring and evaluation

3.10 Project activities will be carried out in accordance with an annual program established in annual work plans (AWPs), to be agreed on with the Bank at semiannual monitoring meetings. The AWPs will contain at least the following information: (i) an evaluation of the activities carried out in the preceding period and the accomplishments; (ii) a description of the activities to be carried out in the next six-month period; (iii) the objectives and targets (by quarter) for each group of activities and the indicators that will be used to gauge the extent to which such objectives and targets have been met; (iv) the quarterly works schedule, together with the corresponding costs; and (v) the financing requirements for the period.

3.11 The AWPs will be submitted to the Bank in the first month of each six-month period to allow time for organizing the annual meetings to take place before the end of the next semiannual period. The executing agency and the Bank will meet every six months to monitor and assess the progress made in the preceding six-month period, and to determine the extent to which the criteria for disbursement and project technical execution have been fulfilled and to agree on the corresponding annual work plans.

H. Lessons learned

3.12 **Political support, legal assistance, and institutional leadership**. The results of the presidential and parliamentary elections held in June 2002 showed that the electorate was polarized into four different political camps, without any party holding a clear majority, and that new political groups were emerging from outside the traditional party system. This new configuration of parliamentary forces prevented the formation of a majority in the parliament that was needed for the election of a new president, and later influenced the design of the government's program and how it was subsequently implemented. Following lengthy negotiations in August 2002, a new president was elected and a coalition government was formed by two parties with the partial support of other smaller parties.

3.13 In the final quarter of 2002 and the first quarter of 2003, the Bolivian government working in this climate of parliamentary instability prepared a macroeconomic program to restore growth and to control and reduce the deficit. At the same time, negotiations opened with the International Monetary Fund on a new agreement under the Poverty Reduction and Growth Facility. The government's new program arranged with the IMF was to include tax policy reforms such as the introduction of the income tax, a simplified tax regime, and amendments to the hydrocarbons legislation. Other measures included efforts to cut spending on personnel and to place a ceiling on soaring pension costs, all of which were brought into the sector program that the Bank was preparing together with the Bolivian government. In February 2003, these reforms were introduced in the Legislative Branch in the form of a new proposed budget for 2003. The reforms proposed in the bill, particularly those relating to tax policy and government wages and salaries, were not only opposed by the opposition but they also sparked mass demonstrations and protests that led to riots and civil disorder.

3.14 In the face of such opposition, the government withdrew the budget reform bill and initiated a consultative process on a revised budget bill, and shuffled most of the government team. A new bill was introduced in the Legislature and is now being reviewed by the Finance Commission of the Chamber of Deputies. The tax policy measures originally planned have been left out of the new bill, which has less draconian spending controls, particularly in the areas of current and capital spending. This latest government proposal adheres to the new deficit targets agreed on with the IMF that are part of a new stand-by agreement now under study by the IMF Executive Board. The present operation is designed to augment revenue collection, reduce inefficiencies, and control pension spending. To this end, the measures and targets it contains will be consistent with the eventual agreement with the IMF.

3.15 The Legislature recently passed the Executive Branch Restructuring Act (LOPE), which seeks a profound restructuring of structure of the government. The act's enabling regulations (DS 26973) do not contain any significant changes affecting taxation and the Office of the Deputy Minister of Pensions, which until that time had been part of the Office of the Deputy Minister of Financial Affairs, was eliminated and integrated into the new structure with the rank of division within the Ministry of Finance. Under the Executive Branch's commitments with the Bank, all authority for pension payments will rest with the Office of the Deputy Minister of Budget and Accounting, with the creation of the Pension Payments Administration, whose functions are oversight, regulation, and control of the system. The administrative functions will be transferred to a new deconcentrated national service. A management contract will be signed between both institutions. In leading this process of institutional strengthening and technical cooperation, the Coordinating Unit will be located within the Pension Payments Administration in order to have the necessary political support and ensure that the framework is institutionally consistent.

3.16 **Communications and dissemination.** As part of the project, actions will be undertaken to disseminate within and outside the government the objectives, activities, and targets of the fiscal sustainability support program (BO-0213). It is particularly important to enhance the Internal Revenue Service's public image as a government entity that operates on principles of professionalism, probity, and transparency. As to an institutional framework for pensions, a communications plan must be designed to disseminate the progress made in the institutionalization process, in terms of efficiency and effectiveness, superior service to the public, and the probity of its employees.

3.17 **Small gains.** The process of reform is a complex one involving many different participants. Any successes emanating from the process must be perceptible and must be obtained quickly and used to demonstrate that the reforms under way are working. These "small gains" will make it possible to win support amongst the public and those social groups directly affected.

IV. ENVIRONMENTAL AND SOCIAL FEASIBILITY

A. Technical and institutional viability

4.1 The technical-cooperation project was conceived to conform closely to the mission and functions of the Ministry of Finance and the Internal Revenue Service. Specifically, all project activities are consistent with the tasks corresponding to the Internal Revenue Service and the Pensions Payments Administration. Also, the scope of this project was designed with the active involvement of and in consultation with the officials monitoring the different components in each agency. It was previously ascertained that they have the capacity to follow up and provide guidance on execution of the operation. Accordingly, there is enough commitment to the operation to ensure that it will be accepted and successfully completed.

4.2 It is important to note that the Internal Revenue Service has been the beneficiary of other Bank technical assistance projects. Hence, the agency has officials already familiar with implementing and administering operations of this kind, a factor that will facilitate the operation. To establish a National Pension Payments Office with a proper institutional framework, advisory assistance will be provided by an expert to support the Pension Payments Administration.

B. Environmental and social feasibility

4.3 The sector project was considered and approved by CESI on 28 March 2003. Given the nature of the program, it will have no direct environmental effects it includes policy measures concerned solely with improving the efficiency of tax revenue collection and modernizing the national pension system.

C. Benefits

4.4 The technical-cooperation project will help make the Bolivian government’s fiscally sustainable by enhancing the efficiency and effectiveness of the Internal Revenue Service, the body in charge of tax collection. On the pensions side, the project addresses the concerns raised about the high level of fraud and the poor credibility of the Pensions Administration, the institution responsible for administering payments under the public PAYG regime and about unreliable and inaccurate administrative records, which directly affect recognition of pension benefits. The project will seek to resolve these problems and introduce appropriate tools for attaining the goals set out in the fiscal sustainability support program (BO-0213).

D. Risks

4.5 The main risk associated with the program has to do with economic policy reforms. The viability of the pension system reform depends on whether those who stand to lose are clearly identified and can mobilize sufficient political capital to defend their interests as well as on whether winners will emerge from parallel reforms put in place. In the past, three main reasons accounted for the relatively rapid pace of pension reform in Bolivia: the president enjoyed a comfortable parliamentary majority; the effects were offset by the soaring number of first-time savers in the individually funded system and of *Bonosol* beneficiaries; and many specific effects of the reforms were intangible, during a transition period that had been generously accommodating to more than just a few of the groups that might feel threatened.

4.6 The present situation is very different because the president lacks sufficient parliamentary support and there is little likelihood of being able to identify parallel beneficiaries to make up for the rationalization of the PAYG system. Given this backdrop, a legislative package to reform the parameters of that system that results in drastic spending cuts is not considered politically feasible. Consequently, the present project is betting on gradual policy reforms, with a focus on efforts at administrative rationalization and fraud prevention, which, by not clearly identifying the losers and being introduced slowly by degrees, is likely to weaken potential resistance from those affected. However, given the potentially pervasive presence of corruption in society and the role discharged by intermediaries, organized resistance to the proposed measures cannot be ruled out. The introduction of new communications and pensioner service policies is considered essential for minimizing these risks.

4.7 Also, the strengthening of the tax and pensions administrations risks politicizing the country's public sector and creating a deficit of professionally trained personnel. This problem is less of a concern in the case of the tax administration, which is being modernized under an institutional arrangement supported by the World Bank and the IDB. The risk perceived on this front is whether or not the arrangement will continue to be sustainable after the program has been completed. To counter this risk, conditions will be established under the program to consolidate the institutional framework.

4.8 On the pensions front, the risk is greater insofar as the entity suffers from institutional weakness and human resources policies have traditionally been based on cronyism and nepotism. This risk is not inconsistent with the entity's position as an important link in the economic policy reform described. In this case, the program is geared to establishing a new institutional and organizational system that legitimizes the institutional framework through the creation of a national professionally staffed pension system characterized by transparency and results-based management. In such a scenario, the availability of sufficient technical-cooperation funding to sustain this mechanism is considered a critical variable in neutralizing this risk.